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ONGOING AND FUTURE RESEARCH

Trade-related aspects of intellectual property rights and trade-related investment measures

Report of the Secretary-General

SUMMARY

Trade-related aspects of intellectual property rights (TRIPs) and trade-related investment measures (TRIMs), have been under intensive discussion in the current Uruguay Round of GATT negotiations. An important dimension of TRIPs and TRIMs is their role in global (and national) investment and technology flows and in the promotion of economic development. The present report shows that there is conflicting empirical evidence on the positive or negative impact of TRIPs and TRIMs on investment and technology flows in particular countries and industries. Although further research is needed to arrive at more definitive assessments, it seems clear that the diversity of socio-economic and industrial conditions in different countries may warrant different sets of policy measures in these areas. Intellectual property protection is considered to be an important determinant of investment and technology flows in the new technological age, but it may still be necessary for countries to complement such protection with measures to ensure access to and diffusion of technology (as these may not always occur automatically through market forces). Similarly, public policy considerations may warrant the use of particular TRIMs in order to maximize or enhance the contributions of foreign investment to socio-economic development in host countries, or to counterbalance adverse effects of market forces and corporate strategies.

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INTRODUCTION

1. The Commission on Transnational Corporations, at its fifteenth session, requested the Secretary-General to prepare a report on the research programme of the United Nations Centre on Transnational Corporations for consideration by the Commission at its sixteenth session. 1/ The present report has been prepared in response to that request. It reports findings generated by one part of the Centre's research programme; a full review of the programme is contained in the report of the Secretary-General concerning the activities of the Centre (E/C.10/1990/16).

2. Chapter I of the report deals with the Centre's research on trade-related aspects of intellectual property rights (TRIPs), while chapter II deals with trade-related investment measures (TRIMs). Both of these subjects are part of the current Uruguay Round of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT). Those negotiations are yet to be concluded, and the present report has sought to avoid detailed analyses of the negotiating proposals or value-judgements on the position of any particular delegation. Indeed, the Centre's research interest in these subjects transcends the specific outcome of the negotiations and relates to the linkages between intellectual property protection, on the one hand, and technology and investment flows, on the other, as well as to the impact of trade-related investment measures on both the behaviour of investors and economic development in the countries concerned. There is conflicting evidence, and hence divided views, on each of these issues. This report sets out the Centre's research findings in these areas to date and examines their policy implications for the formulation of intellectual property laws and related measures on the transfer of technology and foreign investment. Issues for further research are also identified.

I. TRADE-RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS

A. Technology and world competition

3. The Uruguay Round negotiations have focused much attention on the establishment of multilateral standards for the protection and enforcement of intellectual property rights as well as on government regulation of foreign investments and services. This attention reflects the interests of corporations and Governments in the leading industrialized countries in the establishment of optimum conditions for the encouragement of technological innovation and for the global commercialization of technology through trade and investment. These interests have been intensified by increasing competitive pressures in the world economy.

4. Major changes have occurred in global trade and investment patterns over the past two decades, evidenced, in particular, by the competitive strength of Japanese transnational corporations, the increasing ascendancy of the newly industrialized countries in international trade, the growing importance of international transactions in services, and the emergence of the United States of America as both a leading host country and the leading home country for foreign direct

investments. 2/ These changes have made it clearer than ever before that a country's competitive position in the world market depends more on its capacity to develop and utilize technology in its production, trade and investments than on its natural resource endowments. The advent of full economic integration in the European Community at the end of 1992 has added new pressures to these changing competitive patterns. Although these changing trade and investment patterns cannot be fully explained by reference to any single factor, the rapid technological advances of the past two decades - particularly in micro-electronics and computer technology - are generally acknowledged to have played a dominant role in these trends. 3/

5. Consequently, increasing attention and resources are being devoted by corporations and Governments, notably in the leading industrialized countries, to the creation of a competitive edge through technological innovation. In the first half of the 1980s, research-and-development spending in the countries that are members of the Organisation for Economic Co-operation and Development (OECD) grew at a faster rate (an average of about 6 per cent per annum in real terms) than the gross domestic product (about 2.3 per cent). Total research and development expenditure in the OECD area stood at about $228 billion in 1985, but partial data for 1985-1987 (for countries accounting for about 80 per cent of total OECD expenditure on research and development) suggest a slow-down to a growth rate of about 4 per cent. The private sector has accounted for about 52 per cent of this expenditure, with Government funding being about 43 per cent on the average. 4/ There has also been a distinct policy of encouraging joint research-and-development projects among major corporations in the United States of America and the European Community, including the relaxation of antitrust restrictions on such collaboration, in view of the competitive advantages that may ensue from the resulting technological innovations.

6. The economies of scale required for the amortization of these research and development investments and the spectre of rapid obsolescence posed by the unrelenting pace of technological innovation further add to the pressures for the globalization of markets. The removal or reduction of barriers to trade, investment and services is thus seen as necessary to facilitate the global commercialization of technology. Thus, at the Punta del Este Ministerial meeting which launched the Uruguay Round of multilateral trade negotiations in 1986, the GATT Ministers agreed to include trade-related aspects of intellectual property rights (TRIPs) (including trade in counterfeit goods), trade-related investment measures (TRIMs) and trade in services on the negotiating agenda. 5/ Although the Negotiations on TRIMS and services are separate from those on TRIPs, the technology issue is a common feature of all three subjects.

B. Intellectual property rights and transnational corporations

7. The TRIPs issue is viewed with great importance by transnational corporations inasmuch as it pertains to the legal protection of their technological assets and to the economic space for the commercialization of those assets. Being the main sources of technological innovation and of investment and technology flows in the world economy, transnational corporations are naturally concerned about the legal protection of such technology in the global marketplace, as indicated by the

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following statement issued on the TRIPs negotiations by the Executive Board of the International Chamber of Commerce:

> "World business reaffirms its view that the Uruguay Round negotiations should produce agreed GATT arrangements dealing with the trade aspects of intellectual property rights, designed to establish fundamental principles and to ensure adequate national and international protection and enforcement for those rights. Such protection is also an important factor in encouraging greater flows of foreign direct investment in developing countries and in stimulating technical transfers to these countries." 6/

This concern is echoed in recent statements made by senior officials of the Governments of the Republic of Korea and Mexico, for example, who perceive that their intellectual property régimes operate as disincentives to investment and technology flows and have undertaken to strengthen the levels of protection provided, apparently in part as a result of bilateral discussion with the United States. 7/

8. One major source of concern in the TRIPs discussions has been the increasing incidence of trade in counterfeit products, mainly attributed to low levels of protection and enforcement of intellectual property rights in developing countries. Counterfeiting and piracy seem to have been greatly facilitated by some of the new technologies themselves, such as the ease of copying computer software and audio and video recordings, although they are not limited to the new technologies. Industry groups in the industrialized countries estimate that the trade losses attributable to counterfeiting and piracy range up to about $60 billion annually, with corresponding losses in employment, etc. 8/ These perceived losses and the changing competitive patterns referred to above have occurred almost simultaneously. The changing competitive patterns may not have been caused primarily by trade in counterfeit products. For example, the United States trade deficit alone has in recent years been about twice as large as the counterfeiting estimates. However, trade in counterfeit products has played the leading role in placing intellectual property rights on the international trade agenda. 9/

9. The basic hypothesis of the proposals for a global TRIPs régime, presented primarily by the leading industrialized countries, is that adequate levels of intellectual property protection are essential for trade liberalization and for the encouragement of foreign direct investment and technology flows. The standards or measures for intellectual property protection proposed by the leading industrialized countries in this regard are the following: 10/

(a) The patentability of all inventions, regardless of subject-matter (and hence the abolition of specific patent exclusions, such as exclusions on pharmaceuticals, therapeutic methods, plant and animal varieties and food products). Such protection must confer exclusive use and manufacturing and commercial rights for at least 20 years;

(b) Protection of trade marks, including service marks, well-known marks and geographical names, on the basis of use or registration, for no less than 10-year

terms, with an indefinite number of renewals, and excluding others from using the same or similar marks for the same or similar goods;

(c) Copyright protection for all forms of original expression, regardless of the medium (i.e., computer programs, literary, musical, dramatic and cinematographic works and works in other forms) and comprising exclusive commercial, distribution and reproduction rights for the life of the author plus 50 years (or for 25 years in the case of computer programs);

(d) Legal protection for any original layout design of semiconductor chips or integrated circuits, in the form of exclusive use, reproduction and commercial rights for at least 10 years;

(e) Limitation of compulsory licensing to situations recognized in relevant international conventions, or for reasons of national emergency or violation of antitrust or competition laws, such licensing to be non-exclusive and subject to payment of compensation at market value;

(f) Enforcement measures, including the imposition of civil and criminal penalties, to deter infringements of intellectual property rights and trade in infringing goods both internally and at national borders;

(g) The application of national treatment, most-favoured-nation treatment and transparency standards to intellectual property laws and regulations.

10. However, there are divided views on the extent to which intellectual property protection actually promotes technology and foreign-direct-investment flows and on the need to complement such protection with measures designed to ensure the use of intellectual property rights in local production and to promote indigenous technological and industrial development. Accordingly, the developing countries have argued that the levels of intellectual property protection, and the conditions attached to such protection, should be left largely to the discretion of each country, as is currently the case under prevailing international instruments, 11/ in order to allow full consideration of different national socio-economic conditions and development needs in the formulation of relevant laws and policies.

C. Rationale for intellectual property protection

11. The standards for intellectual property protection set out above have been presented in the context of trade liberalization and the control of counterfeiting. However, they are intertwined with investment and transfer-of-technology issues in at least two respects: first, as noted above, legal protection of technology is considered necessary for its utilization in investment, licensing and transfer-of-technology arrangements; second, compulsory licensing of protected technology is considered a necessary policy option by many developed and developing countries in situations where such technology is not utilized for local production, or for other public policy reasons. 12/ Thus, while standards of protection and enforcement address the rights of the owners of intellectual property, these are often accompanied by conditions and obligations that are part of the investment or industrial policies of the countries concerned.

12. Indeed, the basic rationale for intellectual property protection has traditionally been the promotion of national technological and industrial development, within which varying emphasis has often been placed on the promotion of domestic as opposed to foreign investment. The exclusive proprietary and economic rights granted to inventors and holders of intellectual property, which are essentially economic monopolies, have usually been considered a necessary departure from the strict control of monopolies because of the broader benefits derived or expected by society in terms of scientific, technological and economic advances. 13/ In any case, there are divided views on the role of intellectual property protection in investment and technology flows, which is probably attributable to the insufficiency of empirical evidence on such linkages and to important contradictions in the available evidence.

D. Impact of intellectual property protection on technology and investment flows

13. At the theoretical level, logical correlations can be drawn between increased levels of intellectual property protection and increased innovative and economic activity, including increased trade, foreign direct investment and technology flows. It stands to reason that the legal protection of intellectual property would provide the necessary incentive for the investment of resources in technological innovation and the legal security for the utilization of technology in production, investments and trade, with broader socio-economic benefits for the larger community.

14. There are indications that a positive link does indeed exist between intellectual property protection and foreign-direct-investment and technology flows. For the computer software industry, an OECD study mentions lack of software protection as a major disincentive to foreign direct investment: "the lack of explicit software protection has reportedly kept some software firms from entering and providing the latest versions of programs to other countries. The lack of legal protection in some countries and the important differences in the enforcement of national laws protecting software, where they exist, represent a disincentive to invest in development". 14/ Insufficient protection of computer software is mentioned as a major concern by 20-38 per cent of the companies interviewed for a 1985 survey. 15/ A study by the United Nations Conference on Trade and Development (UNCTAD) on transfer of technology points out that investment in new technologies (computer programs, integrated circuits and biotechnological inventions) and their diffusion hinge to a large extent upon the type of protection they are granted. 16/ An OECD survey of international technology licensing named limited or unsatisfactory protection of industrial property rights as one of three main problems and disincentives associated with licensing in developing countries (cited by 75 per cent of the respondents, after foreign exchange controls and government regulations on transfer of technology agreements). 17/ The enterprises interviewed reported that those difficulties had caused undue delays (72 per cent), had resulted in the termination of an agreement (20 per cent) or had prevented an agreement from being reached (52 per cent). 18/ Other areas of particular concern for high-technology enterprises were the lack of comprehensive international protection of semiconductor component masks, computer software and computer-related technology. 19/

15. Similarly, the pharmaceutical industry believes that the "lack of reasonable patent policy for pharmaceuticals has been an important factor adversely affecting investment decisions in many developing countries". 20/ As evidence, it observes that the restriction of patent rights for pharmaceuticals in Argentina, Brazil, Canada, India, Thailand and Turkey has caused a decrease of research-based drug companies investing in these countries. For example, the number of research and development-based pharmaceutical firms doing business in Turkey is reported to have declined from 12 to 7 after the abolition of patent protection for pharmaceutical products in 1961, although there is other evidence indicating increased investment by the remaining companies in that sector after 1961 (see para. 19 below). In Argentina, 12 pharmaceutical transnational corporations are reported to have disinvested because of an "impossible public policy environment". Thailand is said to have a "bad" or "very bad" image for foreign investors resulting from poor patent protection policies. 21/ Patent protection is considered to be one of three major factors (besides drug approval procedures and pricing) which determine foreign direct investment by pharmaceutical companies. 22/ Thus, a spokesperson for the United States Pharmaceutical Manufacturer's Association, commenting on efforts by the Government of India to liberalize licensing, production and pricing controls in order to induce an increase in investments by United States drug companies, stated that negotiations would become difficult because of India's insufficient patent protection. 23/

16. At present, pharmaceutical transnational corporations invest at three different levels: research and development, synthesis of active ingredients and manufacturing drugs. The location of investment at the first two (technologically valuable) levels seems to be also dependent upon the country's intellectual property protection or on its scientific infrastructure. Pfizer International, for example, at present invests only at the finishing level of most generic drugs in developing countries, where almost no technology is transferred. Investments at the other two levels are reserved for countries with enhanced patent protection (e.g., European Community countries and the United States). A spokesperson for the firm, however, suggested that Brazil and India, with their large pool of skilled workers and scientists and their attractive markets, would be considered for research and development based investments if they would strengthen their patent protection. 24/ In this context, Canada, Ireland, Italy, Japan and the Republic of Korea are mentioned as examples for transnational corporation-induced growth of research and development investments. 25/

17. However, the interrelation between intellectual property protection and the promotion of investments is much more complex than this argument would suggest. First, in the literature on investment determinants, intellectual property rights have not been considered major factors in most investment decisions, 26/ although the increasing attention being paid to them in recent years would tend to suggest otherwise. Secondly, levels of protection have not always been the same in the industrialized countries, and a general assertion that high levels of economic development are attributable to high levels of intellectual property protection is therefore unwarranted. Thirdly, low levels of intellectual property protection have sometimes been used to promote infant industries (by precluding or minimizing the monopolization of markets by holders of intellectual property) or to develop local competitive capacity. For instance, patent and copyright protection in the United States were for long periods on terms more favourable for nationals than for

foreigners. As noted by a former senior official of the Office of the United States Trade Representative, "our treatment of foreigners under our intellectual property laws reflected an attitude similar to that of some developing countries today". 27/ Indeed, the "manufacturing clause" under United States copyright law, which extended copyright protection only to works manufactured in the United States, was only abolished as recently as 1986 after a GATT complaint by the European Community. 28/ Fourthly, for periods of up to a century or more, several European countries made patent protection conditional on local working or manufacture on penalty of forfeiture or compulsory licensing, and some still maintain compulsory licensing provisions in their industrial property laws. 29/

18. A striking example of the industrial promotion effects of what would currently be regarded as inadequate patent protection is afforded by the history of patent protection for pharmaceuticals in Germany and Switzerland. Under its Patent Act of 1877 (until the provision was finally replaced in 1967 after several previous amendments), Germany prohibited the patenting of pharmaceutical products but allowed the patenting of the chemical formulae or processes for the production of such products. (This system of protecting pharmaceutical production processes but not products is currently still practised by about 49 countries, both developed and developing.) 30/ The protection of pharmaceutical processes but not products encouraged the development of the German chemical and pharmaceutical industry and had, in fact, been consistently advocated by it, since it allowed improved manufacturing processes to be used to produce the same products without infringing on a product patent. However, it also had the unintended effect of stimulating competition from the Swiss industry, which could use manufacturing processes that were not patented in Switzerland and could export to the larger German market without infringing on any patents. Although incremental changes were made in the German patent (and customs) laws over the years to increase the levels of protection and hence to undercut the Swiss competition, it is quite evident that the lower levels of patent protection that existed previously stimulated technological innovation and the growth of the chemical and pharmaceutical industries not only in Germany but in Switzerland as well. 31/

19. Moreover, a recent case study on the Turkish pharmaceutical industry showed that the abolition of product (but not process) patents for pharmaceuticals in that country in 1961 did not adversely affect inflows of technology or foreign direct investment in pharmaceuticals: "even in the absence of patent protection in the pharmaceutical industry, the amount of foreign capital investment rose considerably, at least as far as those firms for which data was available were concerned" - the increase being from about 96 million Turkish lira (LT) in 1973 to over LT 700 million in 1980 for five firms. 32/ This was despite the fact that there was at that time a simultaneous government policy of restricting foreign direct investment in the pharmaceutical industry in order to encourage the growth of domestic firms. When the investment controls were relaxed in 1980, the Turkish subsidiary of Hoffmann-La Roche, for example, increased its capital to LT 218,149,000 in 1980, to LT 323,532,000 in 1982, then to LT 700,000,000 in the same year, and to LT 900,000,000 in 1983. 33/ All of this occurred despite the absence of patent protection for pharmaceuticals. Comparing this to investment trends in other sectors in which patent protection was provided (namely, the electrical, automotive, sewing machine, chemical, and food and beverage industries), the study actually found lower rates of growth for foreign direct

investment among the latter: "in these industries the presence of patents does not affect the increase in [foreign direct investment]. In sum, it seems that no simple causal link can be made between patents and foreign investment". 34/

20. A similar finding concerns the absence of any adverse impact of the patent abolition on technology licensing arrangements or on the introduction of new drugs:

> "Of the 1,319 commercially available drugs in 1982 which were introduced between 1954 and 1982 and for which historical data was available, 270 products (20.5 per cent) were introduced between 1954 and 1961 [when there was patent protection], and 1,049 (79.5 per cent) were introduced from 1962 onwards. Moreover, 80.2 per cent of all the products introduced following the abolition of patents have been produced by the locally-owned firms either through licensing contracts or, in many cases, through access to non-patented sources of technology. In sum, it is evident from the above findings that licensing agreements did not depend in a systematic way on whether or not there was patent protection in the country." 35/

21. Several evaluations of intellectual property protection in developing countries also suggest that such protection has had very little influence on foreign-direct-investment flows or on the tranfer of technology. For instance, a joint study by UNCTAD and the World Intellectual Property Organization (WIPO) in 1975, which led to negotiations on a draft code of conduct on the transfer of technology, concluded that about 84 per cent of all patents in developing countries were foreign-owned, mostly by corporations based in five industrialized countries and that 90-95 per cent of these foreign-owned patents were not used in investments or domestic production in the developing countries. Statistical evidence on the role of patent protection in foreign-direct-investment flows was hard to find, but summaries of questionnaire inquiries from other published sources indicated that patents had little influence on investment decisions. The small proportion of patents actually used in local production (ranging, in developing countries, from 0.3 per cent up to 10 per cent in a few cases, compared to 15-60 per cent in developed countries) did represent a transfer of technology, but such transfer arrangements frequently imposed high royalty payments and charges for technical services, thus raising the direct costs of obtaining the technology. In addition, a broad range of restrictive practices imposed heavy indirect or hidden costs. 36/

22. Finally, a recent case study on Nigeria also confirms the overwhelming dominance of transnational corporations in patent ownership, the low incidence of local working of patents through investment or transfer of technology arrangements, their predominant use to cover imports and to eliminate or control competition, and the prevalence of restrictive business practices in licensing agreements. With regard to local working (which indicates the linkage between industrial property protection and foreign direct investment or licensing), it was found that "in a sample of 590 patents, only 40 patents are being worked effectively in the country. This represents only 6.8 per cent of the sample total and compares with our national estimate of 5 per cent exploitation rate. The lowest exploitation rates are found among the most technologically-intensive and dynamic industries, such as the pharmaceutical, chemical, and machinery and tools industries, which together accounted for about 57 per cent of the patent grants in 1973 and 51 per cent in 1981 in the manufacturing sector". Higher exploitation rates

(5-10 per cent) were found with respect to older technologies, such as in food products, cosmetics and textiles. 37/ This suggests that, even where patent protection is provided, foreign investors may prefer to exploit older rather than newer technologies in developing countries. The study attributes the low incidence of local working in part to the heavy import dependence of the Nigerian economy and the relatively low level of market development and in part to global corporate strategies. Overall, the Nigerian patent system succeeded in attracting foreign-owned patents in large numbers but failed to achieve any of its other objectives, such as the disclosure of patented knowledge, working of patented inventions, or the stimulation of domestic inventiveness. These failures are attributed not only to the monopolistic practices of foreign patent holders but also to the inefficiencies of the Nigerian patent system and the lack of political will on the part of the Government to rectify these defects.

E. Conclusions and policy implications

23. In conclusion, it is clear that, while a causal link may exist between intellectual property protection, on the one hand, and foreign investment and technology flows, on the other, its actual existence and its importance can only be confirmed through experience and empirical evidence. The perception that there is such a link makes the issue important in itself, as this perception can influence policy discussions and measures. But definitive conclusions on the actual existence of such a link and its nature require further empirical research, which the United Nations Centre on Transnational Corporations is in the process of undertaking.

24. At this stage, it can only be surmised that this impact is likely to vary in different countries, and perhaps in different industries, on the basis of different sets of factors, as is suggested by the mixed empirical evidence reviewed above. It would appear that the same levels of intellectual property protection in different countries may be followed by actual investment in production (including foreign direct investment), or by transfer of technology through licensing arrangements (or by different volumes of investment and technology flows), in some but not all countries. For some countries intellectual property protection may be used predominantly to cover imports of the protected goods in question and may thus contribute to balance-of-payments problems. The areas and intensity of impact in different countries and industries would tend to be determined by different combinations of factors over and above the level of intellectual property protection - such as the investment climate of the particular country, the size of its market, the global investment strategies of the particular investors, the type of technology involved and the feasibility of protecting it by other means, and a broad range of factors that influence the investment decision. The differences in potential impact among countries would suggest the need for different policy approaches. The host country's investment and transfer-of-technology policies, as well as corporate investment strategies, are probably of greater importance in determining investment and technology flows than is the level of intellectual property protection.

25. Most of these issues are also of direct relevance to the negotiations on the code of conduct on transnational corporations. 38/ The draft code does not mention intellectual property protection specifically. However, its generally accepted orientation towards enhancing the contributions of transnational corporations to economic development, and specific provisions on the observance of the development objectives of host countries, would tend to suggest, for the TRIPs régime, the establishment of an appropriate balance between the protection of intellectual property rights and measures designed to increase access to and transfer of technology. As in the case of other transnational corporation-related issues, many developing countries will need continuing technical assistance in the design of an appropriate set of policies to facilitate the achievement of these objectives.

II. TRADE-RELATED INVESTMENT MEASURES

A. The concept of trade-related investment measures

26. The Uruguay Round negotiations on trade-related investment measures (TRIMs) seek to establish multilateral standards to govern the use of trade-related investment measures by host countries. The notion of a distortion of trade patterns has been the main rationale for the discussion of TRIMs. Such distortion is deemed to occur when business decisions are made on the basis of considerations other than market forces. Besides host-country measures, it would seem that all measures directed at foreign investors or affiliates, including corporate and home-country measures, could be regarded as TRIMs to the extent that they may distort trade and investment patterns.

27. The initial discussion of TRIMs in the general literature has focused mainly on two broad categories: investment incentives and performance requirements. Examples of investment incentives usually cited in the literature are various forms of tax relief and exemptions, accelerated depreciation (also a tax incentive), import duty exemptions, subsidies, investment grants, priority access to credit, tariff protection and other forms of fiscal, financial and commercial inducements or protections for investments. Local content and export requirements are the most frequently cited examples of performance requirements in the literature, although many others have been cited in the Uruguay Round negotiations. 39/

28. About 14 investment measures have been mentioned in those negotiations, all by developed countries, but mostly as illustrations of the types of measures at issue rather than as a definitive catalogue of TRIMs. However, there is considerable dispute, both among the developed countries and between them and the developing countries, on the characterization of particular measures as TRIMs. In addition to these measures, two other categories of measures applied by transnational corporations and home countries may have trade-distorting effects that are similar to those attributable to the measures identified at the Uruguay Round. Table 1 lists four categories of measures which could be characterized as TRIMs (incentives, performance requirements, corporate measures and home country measures) and their possible impact on trade and investment flows.

Table 1. Trade-related investment measures and their possible impact on trade and investment

Measure	Possible economic impact
Investment incentives a/	Influence location of investments
Tax concessions	
Tariff concessions	
Subsidies	
Investment grants	
Performance requirements	
Local equity requirements a/	Restrict ownership of investments
Licensing requirements a/	Require technology transfer
Remittance restrictions a/	Restrict external financial transfers
Foreign exchange restrictions b/	Restrict external financial transfers
Manufacturing limitations b/	Restrict production
Transfer of technology requirements c/	Require technology transfer
Domestic sales requirements d/	Displace imports
Manufacturing requirements e/	Displace imports
Product mandating requirements e/	Displace other exports
Trade balancing requirements e/	Displace other exports
Local content requirements f/	Displace imports
Export requirements f/	Displace other exports
Import substitution requirements	Displace imports
Corporate measures (restrictive business practices) g/	
Market allocation	Restrict exports
Collusive tendering	Excessive pricing for imports
Refusal to deal	Restrict exports/imports
Exclusive dealing	Export prohibition
Tied sales	Displace other imports/exports
Resale price maintenance	Excessive pricing for imports
Price fixing	Excessive pricing
Differential pricing	Excessive pricing
Transfer pricing	Excessive pricing for imports; low pricing for exports

Table 1 (continued)

Measure	Possible economic impact
Home-country measures	
Export limitation on foreign affiliates	Restricts trade
Preferential taxes for income on investments	Subsidize investments

Source: United Nations Centre on Transnational Corporations, based on negotiating proposals at the Uruguay Round and other material.

Note: The countries identifying particular measures in the Uruguay Round are indicated as follows:

a/ United States.

b/ European Community and the United States.

c/ Japan and the United States.

d/ European Community, Japan and the United States.

e/ European Community, Japan, Switzerland and the United States.

f/ European Community, Japan, Switzerland, the Nordic countries and the United States.

g/ India.

29. Local equity requirements prescribe minimum percentages of local equity ownership, either as a general investment policy, or in certain priority sectors, such as natural resource ventures in many developing countries. They thus, in effect, allow only joint ventures between foreign and local investors in the particular countries or sectors. Technology transfer and licensing requirements are designed to ensure that foreign investors transfer or license particular types of technology to local firms or partners as a condition for conducting business in the host country. Remittance and foreign exchange restrictions impose controls on the transfer of funds from the host country. Manufacturing requirements oblige an investor to produce certain components or products locally and may be similar to local content requirements where the components are used as inputs in other manufacturing activities. Manufacturing limitations, on the other hand, prohibit a foreign investor from producing particular goods, which are often reserved for local firms. Product mandating requirements are described in the Uruguay Round negotiations in terms similar to export requirements, in that a foreign investor is required to export particular products to specified countries or foreign markets. Trade balancing requirements also overlap with export requirements in that they require investors to balance any imports by exporting a corresponding proportion or value of their own production.

30. Local content requirements prescribe minimum percentages of domestic inputs in manufacturing processes, in order to ensure or promote the use of local products and fuller integration of foreign investments in the national economy. They are also commonly used in rules of origin, but as value-added criteria as a condition for the enjoyment of trade preferences or in common market arrangements. A case in point is the recent dispute over the imposition of import restrictions on Nissan cars exported from the United Kingdom of Great Britain and Northern Ireland to France (despite free movement of goods within the European Community) on the basis of insufficient local content or value-added in the United Kingdom. 40/

31. Investment incentives and performance requirements are among the armoury of instruments used by Governments, in developed and developing countries alike, to grapple with market forces in a world of imperfect competition. They enable Governments to influence the behaviour of investors along desired patterns as well as to counteract the negative effects of market forces. With investment incentives, host countries attempt to deal with structural imbalances in their economies by giving special advantages to investments in particular sectors or locations. Previous work by the Centre 41/ indicates that incentive programmes of a fiscal, financial or commercial nature can be found in virtually every country and are usually designed to attract foreign direct investment and to promote national economic development. Performance requirements are also used to foster the integration of foreign affiliates into the national economy, to enhance their contributions to development objectives and to minimize perceived negative effects of global corporate strategies, such as intra-group transfers of income to profit centres outside the host country and corporate restrictions on transfer of technology and on the trading patterns of affiliates or licencees. In sum, "performance criteria have played an important part in diffusing some of the tension between host countries and TNCs. They are the instrument for reconciling the global strategy of the investor with the immediate interest of the host country in foreign exchange reserves, backward linkages and other developmental objectives". 42/

Box 1. Local content: the case of Nissan in Europe

The case of Nissan in Europe (as of other Japanese automobile manufacturers establishing assembly plants abroad) represents a classic example of foreign investment to protect export shares in response to protectionist actions or threats. A major concern of the host country in such situations is to ensure that the investment is not a mere "screwdriver factory" that only assembles imported components in order to avoid import restrictions on the finished product. This concern lies behind the imposition of local content or value-added requirements. The decision of the Government of France (effective 1989) to include Nissan Bluebird cars imported from the Nissan plant in Sunderland, United Kingdom, in Nissan's French import quota - thereby treating them as Japanese exports - was on the basis of insufficient local content in the United Kingdom. At the time the dispute arose, the local (United Kingdom) content of the cars was calculated at 70 per cent and was expected to reach 80 per cent by the end of 1989, whereas France (and Italy as well) required 80 per cent minimum local content, below which the car was considered of non-European origin and subject to import quotas. The controversy over those import restraints became part of a general debate over the European Community's strategy to restore the competitiveness of the European automobile industry after 1992, a debate which is yet to be concluded but which has contemplated the possibility of replacing national import quotas with global community quotas or of negotiating "voluntary" export restraints on Japanese cars.

32. But investment incentives and performance requirements have been subjected to several levels of criticism. It is argued that host countries, both developed and developing (but more frequently developing countries), behave in an inconsistent manner by using various incentives to attract foreign investment and at the same time imposing performance requirements, which operate as disincentives to investment. The competition to attract foreign investment is also seen as forcing countries to offer more incentives than they otherwise would have, resulting in a degree of subsidization that nullifies or reduces gains from the investment. But the central critique has been that any government measure that seeks to alter or influence the investment decision, or the business behaviour of investors, is an unwarranted interference in the free operation of market forces and a distortion of the level and pattern of trade and investment flows, with negative consequences for the economic well-being of the countries concerned and for the efficient allocation of world resources. 43/

33. There are thus, obviously, conflicting views on the propriety of these measures, as well as on their socio-economic effects and overall economic significance; these latter issues are examined in section C below.

B. Interface between trade and investments

34. The TRIMs issue raises a fundamental problem of distinguishing between investment measures that are legitimate in themselves and those that should be

subjected to international disciplines on the basis of their trade-distorting effects. Although this is the first time that systematic attention is being focused on investment issues in GATT negotiations, there have been previous GATT discussions and dispute-settlement cases on such measures as local content and export requirements, domestic procurement, processing and value-added requirements, special credit facilities and tax advantages for foreign investments. 44/

35. The problem of distinguishing between investment measures that have or do not have trade distortive effects is reflected in disputes over the characterization of certain investment measures as TRIMs (see table 1). Influenced by a major test case between the United States and Canada decided by a GATT dispute settlement Panel in 1984 - the FIRA Panel case, in which it had been agreed that "no question could be raised about a country's right to regulate the entry and expansion of foreign direct investments", as distinct from the question whether such regulation was consistent with the country's obligations under GATT 45/ - it was agreed at an early stage that the TRIMs negotations should not deal with investment measures per se, but only with their trade-restrictive effects. However, there has as yet been no agreement on what specific measures should be characterized as TRIMs.

36. The subtle distinction between investment measures per se and their trade restrictive effects has proved rather difficult to adhere to in the TRIMs negotiations. Of the 14 host-country measures identified at the Uruguay Round (see table 1), most of them seem to go beyond the primary focus on trade flows and seem to be more directly related to the investment decision itself, that is to foreign direct investment or capital flows, and to decision-making in the management of such investments. This would seem to be the case with all the measures, with the possible exception of local content or import substitution, trade balancing, domestic sales and export requirements. Developing countries have mostly opposed this broad conception of the scope of the negotiations, and have emphasized the use of investment measures as legitimate instruments for the promotion of social and economic development. Subject to a resolution of the scope or definitional question, it would appear that the TRIMs negotiations touch upon fundamental issues of investment policy and regulation, beyond those relating to trade impact per se. Moreover, were the negotiations to be limited to investment measures with direct trade impact only (as has been argued by some developed countries, such as the Nordic and the European Community countries), the rules to be established may still need to be reconciled with the regulatory discretion of host countries on foreign direct investment.

37. The combined focus on trade and investment issues is also evident in the United States-Canada Free Trade Agreement of 1989 (which covers not only trade but also investments and services), 46/ and indeed in the United States Trade and Tariff Act of 1984, section 307 of which defines international trade to include "foreign direct investment by United States persons, especially if such investment has implications for trade in goods and services". 47/ It is also reflected in the 1988 services protocol to the Australia-New Zealand agreement on closer economic relations. 48/

Box 2. The FIRA Panel case

In the FIRA Panel case, the United States had questioned the use of local purchasing and manufacturing requirements under Canada's Foreign Investment Review Act (1973) as being trade-distortive and inconsistent with the national treatment standard and other GATT provisions. It was also argued that export requirements under that law constituted unwarranted governmental interference in commercial operations and raised questions of dumping of products abroad, as well as of the "nullification and impairment" of previous trade commitments. In response, Canada denied any such effects, and argued, inter alia, that the law left it to investors to make specific undertakings in the investment screening process and that, while such undertakings were legally enforceable, they were not specifically imposed by the law. In its decision, the FIRA Panel found that "undertakings to purchase goods of Canadian origin ... exclude the possibility of purchasing available imported products so that the latter are clearly treated less favourably than domestic products". a/ This constituted discrimination in favour of domestic products in violation of the GATT national treatment standard (art. III.4). The Panel found the element of choice on the part of investors in making such undertakings to be irrelevant so long as there was governmental involvement in the preferential treatment of domestic products. However, the Panel did not find the export requirements to be inconsistent with Canada's GATT obligations. It also considered the local manufacturing requirements to be outside its terms of reference, which had only mentioned the two other requirements.

But one particular decision of special importance to developing countries was the Panel's statement (in response to arguments made by Argentina as an interested party in the case) that, "in disputes involving less-developed contracting parties, full account should be taken of the special provisions in the General Agreement relating to these countries (such as art. XVIII:C)". b/ As has become well-established under GATT, developing countries are allowed greater flexibility in the use of trade-restrictive measures for a variety of reasons, including balance-of-payments problems and infant industry and development considerations.

a/ General Agreement on Tariffs and Trade, "Canada - administration of the Foreign Investment Review Act (Report of the Panel adopted on 7 February 1984)", Basic Instruments and Selected Documents, Thirtieth Supplement (Geneva, March 1984), p. 159. That law was replaced by the Investment Act of 1985.

b/ Ibid., p. 158.

C. Incidence and impact of trade-related investment measures

38. Apart from disputes on the characterization of particular investment measures as being trade-related, the incidence and impact of performance requirements have also been subject to much dispute. Examples of the adverse effects of these measures on trade, investment and technology flows have been cited in the respective negotiating proposals, which emphasize the trade distortion aspects as well as their effects as disincentives to investment and technology flows through interference with normal business behaviour. But it is also relatively easy to provide examples showing that any particular measure may not have trade distorting effects, or that any such effects may be merely incidental or marginal, depending on the particular circumstances. And, of course, it is conceivable that at least some TRIMs do have positive effects on economic development. In the light of these considerations, one has to consider to what extent the incidence of trade-distorting effects may be sufficient justification for the prohibition of the measures in question, as there may be insufficient material injury to the interests of other countries and such measures may also be accompanied by countervailing socio-economic effects that are equally important for the countries applying them.

39. But only a few systematic studies exist on the impact of investment incentives and performance requirements, and on their overall economic significance. The few studies that exist, however, suggest certain preliminary conclusions on the question of incidence (see table 2), as well as on impact (see below).

40. A study sponsored by the World Bank in the early 1980s suggests that investment incentives influence the locational decisions of foreign investors: this was the case in the majority of projects surveyed, that is, 50 out of a sample of 74 investment projects. It was suggested here that, without the incentives in question, the investors concerned would have located those investments in other countries or supplied the local markets of the host countries through exports. This contradicts previous evaluations in the literature (including literature prepared by business organizations), to the effect that investment incentives were of marginal or no relevance to the investment decision. 49/ Of the same sample of investment projects in that study, about half the number were found to have been subjected to performance requirements, the most common of which were on local content, followed by export requirements. However, the study found the impact of those performance requirements to be somewhat mixed: some did have an impact on the investment decision and on trade flows, while others did not. It was only in four cases out of that sample - all in the automobile industry - that performance requirements were found to have influenced the investment decision. In other cases (the number of which was unspecified), performance requirements were found to have reduced imports and increased exports and thereby distorted normal trade patterns. However, the study also pointed to the need for much more additional research on the socio-economic costs and benefits of investment incentives and performance requirements before any normative conclusions could be drawn on them. 50/

41. Finally, in a study sponsored by the Overseas Private Investment Corporation of the United States, the authors came to the following conclusions on the impact and significance of performance requirements: 51/

Table 2. Incidence of performance requirements and investment incentives among United States foreign affiliates, 1982

(Percentage)

Measure	All industries	
	Developed market economies	Developing countries
Performance requirements		
Export requirements	1	3
Import requirements	0.5	3
Local content usage	0.6	2
Employment requirements	4	15
Transfer-of-technology requirements	2	..
Specific export/import ratio requirements	1	3
Investment incentives		
Tax concessions	25	26
Tariff concessions	7	16
Subsidies	18	9
Other	7	9

Source: United States of America, Department of Commerce, 1982 Benchmark Survey Data (Washington, D.C., United States Government Printing Office, 1985).

(a) Performance requirements are part of a much larger phenomenon, namely, the struggle of home and host countries to influence the location of production, the selection of inputs, the scale of operations and the marketing of output on the part of transnational corporations;

(b) Estimates of the extent to which performance requirements actually alter trade patterns, displace production or cost jobs tend to be overstated; such impact varies between industries but the overall economic impact tends to be small;

(c) The extent to which performance requirements cause economic distortions and inefficiencies is mixed. Some may be benign or even beneficial, correcting for other distortions or hastening the process of infant-industry development. Many others produce significant losses in economic welfare. In general, performance

requirements are not a first-best policy instrument, but in a second-best world in which transnational corporations have substantial discretion about how and where to conduct their operations, they serve an important purpose in securing explicit commitments from companies taking advantage of investment incentives.

(c) The extent to which performance requirements cause economic distortions and inefficiencies is mixed. Some may be benign or even beneficial, correcting for other distortions or hastening the process of infant-industry development. Many others produce significant losses in economic welfare. In general, performance requirements are not a first-best policy instrument, but in a second-best world in which transnational corporations have substantial discretion about how and where to conduct their operations, they serve an important purpose in securing explicit commitments from companies taking advantage of investment incentives.

42. Regarding home-country measures, there has as yet been no systematic study of their impact on international trade and investments, other than adverse effects cited in particular disputes (some of which are referred to in paragraph 34 above). One particular source of controversy has been the extra-territorial application of United States re-export controls and other regulations, on which there have been recurrent disputes with other developed countries. 52/

43. As to corporate measures or restrictive business practices, their adverse effects on trade and investments provided the main justification for the adoption of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices ("RBP Code") by the General Assembly in December 1980. 53/ Even so, restrictive business practices have continued to be a major source of concern in developed and developing countries alike - as consistently underlined in annual reports on the RBP Code, the latest one of which noted:

> "At a time when under the Uruguay Round efforts are being made to liberalize international trade, it is of utmost importance to draw attention to the danger that market-sharing and other arrangements at the enterprise level might increasingly replace traditional government barriers to trade." 54/

D. Conclusions and policy implications

44. The above examples are indicative of the tentative state of current knowledge of the global incidence, impact and overall costs and benefits of investment incentives and performance requirements, as well as of analogous corporate and home-country measures. There is thus a great need for further research in this area, which the Centre will continue to address.

45. Here again, the implications of the TRIMs issue for the code of conduct on transnational corporations are even more obvious than in the case of TRIPs. Indeed, the regulatory discretion of countries on the entry and operations of transnational corporations, which is important for both developed and developing countries and is already agreed upon in the draft code, would seem to be central to any discussion of investment measures. The TRIMs issue also raises a fundamental

question concerning the modes by which host countries, particularly developing countries, may pursue their development objectives, and the extent to which they can rely on market forces alone to attract foreign investments or to enhance the advantages derived from such investments. Despite the obvious merits of, and an increasing trend towards, market-oriented investment policies in many countries, it seems clear that some degree of regulatory measures in particular countries or situations may be necessary in order to safeguard important public policy interests which may not always be resolved satisfactorily by market forces. This need may also arise at least occasionally in developed countries as well. More systematic empirical evidence on the socio-economic costs and benefits of investment incentives and performance requirements, as well as of corporate and home-country measures, would thus be useful to most countries in their effort to formulate more effective investment policies, and this calls for further empirical research in this area.

Notes

1/ Official Records of the Economic and Social Council, 1989, Supplement No. 10 (E/1989/28/Rev. 1), para. 107.

2/ See, for example, Transnational Corporations in World Development: Trends and Prospects (United Nations publication, Sales No. E.88.II.A.7), p. 74.

3/ See, for example, W. Michael Blumenthal, "The world economy and technological change," Foreign Affairs, 66 (1988), pp. 529-550; and Raymond J. Krommenacker, "The impact of information technology on trade interdependence", Journal of World Trade Law, 20 (1986), pp. 381-400.

4/ Organisation for Economic Co-operation and Development, Science and Technology Indicators Report, No. 3: R & D, Production and Diffusion of Technology (Paris, 1989).

5/ "Ministerial Declaration on the Uruguay Round", 20 September 1986, in General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, 33rd Supplement (Geneva, June 1989), pp. 19-28.

6/ "Trade-related aspects of intellectual property rights: statement issued by the International Chamber of Commerce Executive Board at its 53rd session", New York, 11 February 1988 (document No. 103/113), mimeo.

7/ Financial Times, 17 October 1989, p. 7.

8/ Ibid.

Notes (continued)

9/ The United States trade deficits, which grew from about $25 billion in 1980 to over $180 billion in 1986, are due to much more fundamental economic factors than to trade in counterfeit products; see, for example, Trade and Development Report, 1988 (United Nations publication, Sales No. E.88.II.D.8), pp. 63-75. For a review of the background to the TRIPs, TRIMs and services negotiations, see A. Jane Bradley, "Intellectual property rights, investment and trade in services", Stanford Journal of International Law, 23 (1987), pp. 57-98.

10/ This is a digest of various negotiating proposals, based on documents of restricted circulation of the General Agreement on Tariffs and Trade; see also United Nations Confererence on Trade and Development, Uruguay Round: Papers on Selected Issues (United Nations publication, UNCTAD/ITP/10).

11/ World Intellectual Property Organization, "Existence, scope and form of generally internationally accepted standards/norms for the protection of intellectual property" (Note prepared for Uruguay Round negotiations, Geneva, May 1988), mimeo.

12/ Ibid.; see also, Paul Demaret, "Intellectual property rights, compulsory licenses and the free movement of goods under Community law", International Review of Industrial Property and Copyright Law, 18 (1987), pp. 161-191.

13/ Alberto Bercovitz, "Historical trends in protection of technology in developed countries and their relationship to protection in developing countries" (Geneva, United Nations Conference on Trade and Development, 1988), mimeo.

14/ Organisation for Economic Co-operation and Development, Internationalization of Software and Computer Services (Paris, OECD, 1989), p. 85.

15/ Ibid., pp. 70 and 71.

16/ United Nations Conference on Trade and Development, "Periodic report 1986: policies, laws and regulations on transfer, application and development of technology" (TD/B/C.6/133), 24 July 1986, p. 2.

17/ Organisation for Economic Co-operation and Development, "International technology licensing: survey results" (Paris, OECD, 1987), p. 32, mimeo.

18/ Ibid., p. 36.

19/ Ibid., p. 40.

20/ Pfizer International, Inc., "The role of pharmaceutical patents in economic development: a mechanism for lower prices, high quality health and assurances of safety", November 1989, p. 2.

21/ Ibid., p. 3.

Notes (continued)

22/ Interview with Michael W. Hodin, Vice President for Public Affairs, Pfizer International, Inc., New York, on 16 November 1989.

23/ World Technology Patent Licensing Gazette, 21 (1988) p. 14.

24/ See footnote 21.

25/ See footnote 19.

26/ See, for example, Stefan H. Robock and Kenneth Simmonds, International Business and Multinational Enterprises (Homewood, Illinois, Irwin, 1989); Robert Grosse and Duane Kujawa, International Business: Theory and Managerial Applications (Homewood, Illinois Irwin, 1988); and John D. Daniels and Lee H. Radebaugh, International Business: Environments and Operations (Reading, Massachusetts, Addison-Wesley, 1987).

27/ Alice T. Zalik, "Implementing the Trade-Tariff Act", Les Nouvelles, December 1986, p. 199.

28/ General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, 31st Supplement (Geneva, March 1985), p. 74.

29/ See footnote 12.

30/ World Intellectual Property Organization, "Exclusions from patent protection" (HL/CE/IV/INF/1), reproduced in Industrial Property (Geneva, May 1988), p. 192.

31/ See footnote 13.

32/ Arman S. Kirim, "Reconsidering patents and economic development: a case study of the Turkish pharmaceutical industry", World Development, 13 (1985), pp. 226 and 227.

33/ Ibid., p. 227.

34/ Ibid., p. 227.

35/ Ibid., p. 228.

36/ United Nations Conference on Trade and Development/World Intellectual Property Organization, The Role of the Patent System in the Transfer of Technology to Developing Countries (New York, 1975), chap. IV; the higher end of the scale for developed countries (60 per cent) represented "commercial utilization", including the use of intellectual property rights in both trade and investments.

37/ Owen T. Adikibi, "The multinational corporation and monopoly of patents in Nigeria", World Development, 16 (1988) p. 517.

Notes (continued)

38/ "Code of conduct on transnational corporations": note by the Secretary-General (E/1988/39/Add.1), 1 February 1988.

39/ See, for example, Stephen Guisinger, et al., Investment Incentives and Performance Requirements (New York, Praeger, 1985); Guisinger, "Investment incentives and performance requirements: they matter", The CTC Reporter, 20 (autumn 1985), p. 38; Theodore H. Moran and Charles Pearson, Trade-related Investment Performance Requirements (Overseas Private Investment Corporation, Washington, D.C., March 1987); Moran and Pearson, "Tread carefully in the field of TRIP measures", The World Economy, 11 (1988), pp. 119-134.

40/ See, for example, "Rules of origin: Commission's turn to act in Nissan affair", Multinational Service, No. 286 (Brussels, 31 March 1989).

41/ Transnational Corporations in World Development ...

42/ Ibid., p. 329.

43/ See references in footnote 39.

44/ There have, for instance, been dispute-settlement cases of the General Agreement on Tariffs and Trade on the trade-distorting effects of the following types of measures: special credit facilities for the purchase of domestic machinery (see General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, 7th Supplement (Geneva, February 1959) p. 60), income tax advantages for foreign earnings of domestic corporations (see Basic Instruments and Selected Documents, 23rd Supplement (Geneva, January 1977), p. 98), income tax advantages for outward foreign investments (see Basic Instruments and Selected Documents, 23rd Supplement (Geneva, January 1977), pp. 115, 127 and 137), and on local content, manufacturing and export requirements (see Basic Instruments and Selected Documents, 30th Supplement (Geneva, March 1984) p. 140).

45/ General Agreement on Tariffs and Trade, "Canada - administration of the Foreign Investment Review Act (Report of the panel adopted on 7 February 1984)", Basic Instruments and Selected Documents, 30th Supplement, (Geneva, March 1984), p. 140.

46/ The Canada-United States Free Trade Agreement, H.R. doc. No. 216, 100th Congress, secord session, p. 297 (1988), reprinted in International Legal Materials 27 (1988), p. 281.

47/ United States Trade and Tariff Act, 1984, Public Law 98-573.

48/ Australia-New Zealand Services Protocol, 1988.

Notes (continued)

49/ The literature on factors affecting the investment decision have generally held that investment incentives tend to be of marginal or no relevance in most investment decisions. See, for example, Transnational Corporations in World Development ..., p. 271; Louis T. Wells, "Investment incentives: an unnecessary debate", The CTC Reporter, (autumn, 1986), p. 58.

50/ Guisinger et al., see footnote 39.

51/ Moran and Pearson, see footnote 39.

52/ See, for example, Kenneth W. Dam, "Economic and political aspects of extraterritoriality", The International Lawyer, 19 (1985), p. 887.

53/ The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (United Nations publication, Sales No. E.81.II.D.5).

54/ United Nations Conference on Trade and Development, "Legislative and other developments in developed and developing countries in the control of restrictive business practices (1985-1988)" (TD/B/RBP/51), 26 August 1988, pp. 1-2.

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STRENGTHENING THE NEGOTIATING CAPACITY OF DEVELOPING COUNTRIES IN THEIR DEALINGS WITH TRANSNATIONAL CORPORATIONS

Experience gained in technical co-operation activities with respect to the formulation and implementation of foreign investment policies

Report of the Secretary-General

SUMMARY

Many developing countries have undertaken a revision of their foreign investment policies within recent years. This development is most striking in developing countries that formerly virtually excluded foreign investment. This paper briefly addresses the experience of the United Nations Centre on Transnational Corporations in assisting such countries in the formulation of new foreign investment policies and strategies. It then proceeds to discuss some issues relating to the formulation of investment policies in the developing world, in general. Among the issues discussed are the framework for the formulation of foreign investment, systems of investment incentives and regulatory policies in the institutional machinery for implementing the policies. In formulating its policies towards foreign investment, a developing country needs to ensure that these are consistent with the changing international economic environment, its other economic and social policies and the comparative advantage it enjoys in terms of factors such as resource endowment, size of the domestic market and the cheap, skilled and disciplined nature of its labour force. Such policy-making requires a fine balance between promotional measures to accelerate the flow of foreign investment and

* E/C.10/1990/1.

regulatory mechanisms that serve to maximize the benefits accruing to the national economy in terms of effective transfer of technology, significant backward and forward linkages and high levels of net foreign exchange earnings. Equally important for successful policy formulation is the need for clarity, transparency and predictability, while maintaining flexibility, an institutional machinery that expeditiously screens and approves foreign investment proposals and a monitoring mechanism that provides feedback on the effectiveness of the impact on the national economy.

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INTRODUCTION

1. At its fifteenth session, the Commission on Transnational Corporations requested the Secretary-General to report further on the experience gained by the United Nations Centre on Transnational Corporations in the implementation of its technical co-operation programme. This paper has been prepared in response to that request.

2. As part of its technical co-operation programme, the Centre has assisted developing countries in pursuing a variety of policies related to the treatment of foreign investment. The Centre is therefore in a unique position to evaluate the experiences of developing countries and the strategies and modalities that inform policy formulation with respect to maximizing the contribution of foreign investment by transnational corporations to national development goals. Among other things, therefore, this report reviews the requirements for effective formulation and implementation of policies, incentives, regulations and administrative procedures with respect to foreign investment.

3. Section I provides a brief, introductory overview of trends within the international environment that have had a significant impact on foreign direct investment flows. Section II concentrates on one particular trend, the liberalization policies recently adopted in various developing countries, and highlights a number of issues that the Centre has encountered in its work with those countries. Section III contains a general framework for the formulation of foreign direct investment policies, while section IV identifies the main questions to be considered when foreign direct investment policies are being formulated. Section V provides policy guidelines on incentives for increasing the magnitude of foreign direct investment flows and section VI reviews the different regulatory policies that States have adopted with respect to the flow of foreign capital. Finally, section VII contains a short discussion on the main prerequisites for the effective administration of foreign direct investment policies.

I. THE INTERNATIONAL ENVIRONMENT

4. From the 1960s to the early 1980s, the rate of growth in world trade declined from 5.5 per cent to 2.7 per cent per year, while the growth rate of output declined from 8.1 per cent to 1.1 per cent. Over the period from 1982 to 1988, the world economy recovered, resulting in an increase in both output growth and trade. This recovery was, however, concentrated in the developed market economies and a few developing countries or areas, namely, the Republic of Korea, Singapore, Mexico and Hong Kong. Meanwhile, the vast majority of the developing countries experienced economic stagnation, at best, and contraction, at worst. A significant factor in this stagnation was the foreign debt burden: the need to service increasing foreign debt obligations forced many developing countries to channel resources away from local expenditure towards their foreign creditors at a time when new capital inflows (foreign investment inflows and lending) were declining. As a result, many developing countries became net capital exporters.

5. An equally significant development in the world economic environment has been the increasing globalization of economic processes such as trade, investment and technology generation and diffusion. This globalization process is proceeding both at the national (country) level and at the company level, within a framework of increasing reliance on market forces and mechanisms. The implications of these developments are crucial for growth and development considerations for both countries and companies (as production agents) alike. Increasing integration has intensified competition, both between countries and between firms. In many respects, a country's economic development has become increasingly dependent on conditions in the world economy. Similarly, a firm's competitive position in any one market is dependent on its operations in other markets and the operations of firms world wide. These trends are expected to continue into the 1990s.

6. Technological advances have played a key role in the increasing integration of the world's economies. New technologies are leading to lower production costs and are therefore playing a crucial role in determining which companies and countries, as production agents, remain competitive. Particularly important for developing countries is the fact that new technologies in certain activities have reduced the labour component of production to such an extent that certain segments of the production process are beginning to return to the home countries since cheap labour and location advantages in developing countries can no longer offset the high costs of shipping and co-ordination of production across borders. Unless developing countries gain access to this technology through transnational corporations, their products will become increasingly uncompetitive and their growth rates may decline to a significant extent.

7. The increasing integration of the world economy, together with the external debt problem and the emergence of new technologies, are, inter alia, persuading developing countries to become more liberal in their policies towards transnational corporations. As the Governments of many developing countries have sought to foster the development of their economies and to increase the competitiveness of their products in markets abroad, they have often turned to transnational corporations in order to acquire technology, management, capital and access to markets. As the foreign debt position of many developing countries worsened and the availability of new foreign loans declined, foreign direct investment by transnational corporations became an alternative to foreign loans.

8. This change in attitude towards transnational corporations is reflected in official investment policies and in the legislative treatment of transnational corporations by many developing countries in Latin America, Africa and Asia, as well as by certain Eastern European countries. Liberalization has occurred both in those countries that have traditionally been host to transnational corporations and in certain economies that were previously closed to foreign capital. In general, developing country Governments are promoting foreign investment more aggressively than at any time in the past. There is a distinct shift away from rigid regulation and towards policies that are flexible and innovative. In view of this particular trend, the following section is devoted to a discussion of various issues of special pertinence to developing countries that have recently opened up their economies to foreign investment.

II. DEVELOPING ECONOMIES THAT HAVE RECENTLY BECOME OPEN TO FOREIGN CAPITAL: SOME GENERAL OBSERVATIONS

9. The main purpose of this section is to identify some of the structural and other features of the newly opened economies that tend to restrict the extent to which such economies may benefit from international assistance in matters relating to foreign investment. The Centre is well-equipped to undertake this exercise not only because of its general expertise in investment issues, but also because, within recent years, it has provided technical advice and services to the Governments of a number of the "new open-door" developing countries. In providing these services, the Centre has drawn particularly on its 10-year experience of technical co-operation with China, which was a pioneer in the process of economic liberalization.

10. From the outset, it should be emphasized that the present analysis is of a preliminary nature. All indications are that the process of economic liberalization occurring in States such as Angola, Ethiopia, Myanmar, the Lao People's Democratic Republic, Viet Nam and the Democratic People's Republic of Korea is still in its early stages. It would, therefore, be slightly premature to draw firm conclusions relating to the pace and extent of the changes in the countries concerned. In addition, while the Centre's range of experience in these countries is constantly increasing, its work in this area tends to be on an ad hoc and highly specialized basis. To date, the Centre has had little opportunity to assess, in a systematic fashion, the overall impact of the new economic policies on the relationship between transnational corporations and each of the countries in question. On the other hand, this issue is worthy of careful examination and, consequently, there is every likelihood that it will be the subject of a detailed study by the Centre at some time in the future. It is expected that such a study will also cover the Centre's experience of technical co-operation with the Union of Soviet Socialist Republics and Eastern European countries, in which the Centre recently conducted seminars on issues arising from the newly promulgated joint venture laws which admit foreign capital.

A. Structural and political factors

11. The developing countries that have recently opened their economies to foreign capital have done so primarily through the promulgation of legislative decrees that indicate the terms and conditions under which investors may participate in locally based industries. The decrees of the individual countries differ from one another both in terms of content and emphasis, but they contain a number of important common features. Thus, for example, they all envisage that the "opening up" process will lead, among other things, to an increase in production for export, the growth of employment prospects and the rapid acquisition of technology by local enterprises. Generally speaking, they also specify the forms of investment that will be allowed and the guarantees and incentives that foreigners will receive upon undertaking an investment project.

12. With respect to particular forms of investment, the relevant decrees all sanction the formation of joint ventures between foreign companies and local enterprises but they adopt diverse positions on issues such as whether foreign

companies may hold 100 per cent of the equity in a particular operation and the extent to which private nationals, as distinct from local state enterprises, may invest in joint venture projects. As to guarantees and incentives, the decrees commonly provide for fair and equitable treatment for foreign investors and, in most instances, they contain an enumerated list of rights (including rights relating to the remittance of profits and expatriate income) to be enjoyed by investors.

13. In general, the legislative decrees in question do not specify detailed rules pertaining to all aspects of foreign investment. Rather, they provide broad policy guidelines and authorize the formulation of specific regulations with respect to either particular industries or special projects. In the experience of the Centre, the officials responsible for implementing the broad guidelines give every indication of backing the provisions of the legislation with concrete action. This is hardly surprising, however, for, without exception, the new rules are considered to be a critical part of the economic development process in the countries concerned. The positive attitude taken by officials is reflected, for instance, in one African country where, within a short time-period, various implementing regulations have been completed for approval and where active steps are now being taken to identify particular foreign companies with the potential to contribute to the development of industries in a number of high-priority areas. A similar level of commitment can also be detected in the strong efforts of a certain Asian country to advertise its new legislation and to promote itself as an emerging centre for foreign direct investment.

14. Prior to the introduction of their new open-door strategy, each of the developing countries under consideration pursued policies that either discouraged foreign investment or treated it as a matter of low priority. At the same time, the basic orientation in those countries is still, in varying degrees, towards State planning and centralized economic management. In the experience of the Centre, certain important consequences follow from this state of affairs.

15. To begin with, the existing laws in some States appear to take little cognizance of regulatory schemes considered necessary by Western businessmen and advisers for the successful organization of foreign investment. Thus, for example, there appears to be some confusion about the role of economic regulations in promoting free enterprise. To overcome this problem an important first step would be to introduce certain basic contract and company law principles to guide foreign investment and other business relationships in general. It may be argued that these should have a higher priority than the preparation of regulations that deal specifically with the entry of foreign investors for the purpose of establishing joint ventures.

16. Secondly, because the countries under consideration place considerable emphasis on central planning mechanisms, it is understandable that their officials are not always completely familiar with the economic and financial concepts employed by foreign investors from market-oriented systems. In this connection, the Centre has found that, although relevant officials are willing to undertake careful study of Western concepts, the magnitude of the task should not be underestimated. In one country, for example, the Centre's experts considered it

essential to explain concepts such as "equity", "profits" and "joint venture operations" to highly placed officials as a part of the process of technical assistance; advisers who assume, without discussion, that such matters are fully understood as a matter of course, may fail to provide the type of assistance the newly opened countries require at the present time.

17. On a closely related point, the Centre's experts have observed that officials in some of the countries in question tend to have very high, if not unrealistic, expectations concerning the immediate effects of their recent policy changes. In particular, some officials seem to believe that the introduction of regulations encouraging investment is sufficient, in itself, to attract a significant inflow of foreign capital in various areas. To some extent, this viewpoint may be a legacy of the tradition of State planning in particular countries, for, within this tradition, there is sometimes a direct and measurable link between State regulations and economic results. Whatever the reason for this viewpoint, however, the Centre believes it should be treated with a fair degree of caution. At most, international investors will regard the new open-door policies as a necessary but not a sufficient condition for investing in the economies concerned, and, accordingly, relevant officials should not be lulled into a false sense of security concerning the potential impact of their recent legislative changes. At the same time, however, it is almost invariably the case that new foreign investment regulations are meant to be regarded not only as new legal rules, but also as important rhetorical pronouncements concerning governmental attitudes to foreign capital. In addressing the issue of high expectations, therefore, the Centre has been careful not to disregard the overall political significance of the policy shifts in the various countries.

18. Another matter that has had some bearing on the value of the technical assistance offered to newly opened countries is the fact that the process of liberalization in those countries has apparently not yet run its full course. In a number of cases, the decision to introduce legislation favouring foreign investment is only part of a broader political debate concerning the role of private enterprise and market forces in the allocation of goods and services in the economy. As this debate is yet incomplete, it is sometimes difficult for external advisers to make unequivocal suggestions with respect to possible government positions. Strictly speaking, this problem is not unique to the countries in question, for, by definition, the economic policies of any Government are a function of political forces that can hardly be described as immutable. For these countries, however, the problem has special dimensions that need to be borne in mind.

19. For one thing, because the new regulations represent a major shift in traditional positions, political opposition tends to be both pervasive and influential; in this environment, it should be realized that advice that may appear innocuous for purposes of foreign investment promotion could have controversial political overtones. Similarly, because of the largely fluid political situation, in some countries the legal rules on foreign investment and related matters contain inconsistencies that will need to be removed if the liberalization process is to be truly effective. To take but one example: in an Asian country which has recently opened its doors to foreign investment, the main regulations on investment

promotion seem to be clearly incompatible with a constitutional prohibition on private ownership by foreigners of the means of production within the country. In such a situation, the Centre's experts have highlighted inconsistencies and recommended solutions, but there is little guarantee that their efforts will influence the relevant policy makers.

20. Perhaps more fundamentally, the Centre's experts may have to accept that certain legal and economic prescriptions will ultimately affect the balance of political forces in the newly opened developing countries. In one Asian country, for example, although measures to promote foreign capital were introduced, the policy makers were initially of the view that rental rates for local industrial property and other such issues should be incorporated into the main investment rules in a somewhat inflexible fashion. To some degree, this approach reflected pre-existing notions concerning central economic planning, but, in the views of experts from the Centre, it would hardly serve to encourage the flow of investment capital from Western economies. Accordingly, the Centre recommended an alternative approach based on market-oriented principles of accounting and valuation, even though it was apparent that this alternative could possibly strengthen the pace of economic liberalization in the country concerned. In another country, pre-existing notions of public ownership of the means of production were evident in the requirement that majority ownership of all joint ventures had to be retained by State enterprises; on the advice of the Centre, this requirement has recently been removed.

B. Some operational issues

21. In addition to the problems outlined above, the Centre has encountered a number of operational difficulties while providing advisory services to the Governments of various newly opened developing countries. These difficulties are not all of the same magnitude and, individually, they may not be particularly serious; when taken together, however, they serve as a significant constraint on the extent to which the countries concerned may benefit from the technical assistance offered by the Centre and other international bodies. Moreover, as some of the difficulties in question relate to matters such as the level of efficiency within local bureaucracies, it can be expected that private foreign investors will also encounter them in the course of time. It is therefore important for the countries concerned to adopt measures that remove or reduce those problems as rapidly as possible.

22. One of the most significant problems in this area is the fact that, in several countries, no single agency is responsible for foreign investment matters in general. Thus, for instance, one ministry may be responsible for technology transfer questions, another may have jurisdiction over labour issues, a third will be in charge of monitoring the foreign exchange implications of capital investment and a fourth will have investment promotion included in its brief. To be sure, this state of affairs is hardly peculiar to the newly opened economies, for, given conventional methods of ministerial allocation in almost all States, foreign investment questions are likely to fall within the purview of different sections of Government. However, in the case of the newly developed economies, there are

particularly strong arguments for the creation of a "one-stop" agency. Among other things, such an agency would allow the Government a greater opportunity to speak with "one voice" on investment matters to the international organizations that happen to be lending technical assistance, and, in so doing, it would minimize the risk that the views of certain sections of Government are ignored when technical advice is being formulated. Furthermore, it would allow for greater co-ordination among the ministries at a time when expertise in matters relating to foreign capital is relatively low and when bureaucratic procedures relating to private enterprise still seem complicated to foreign advisers. It also goes without saying that the creation of a single, responsible agency would help to present a unified, stable picture to private investors and facilitate planning and organization on their part (see also paras. 80-84 below).

23. Another constraint experienced by the Centre is related to the nature of the request for assistance submitted by the Governments of certain newly opened countries. In particular, the requests submitted by particular Governments are sometimes either ambiguous or lacking in essential details. It should be appreciated that the Centre is able to provide assistance of the highest quality only in circumstances where requesting States have a clear perception of their needs and requirements; it is therefore to be hoped that, as the level of technical co-operation between the Centre and the particular countries increases, this problem will diminish in significance. To be fair, however, it should be mentioned that the problem is hardly unique to the Governments of countries with newly opened economies.

24. On some occasions, newly opened economies request assistance from different international agencies with respect to the same subject-matter. As far as the Centre is concerned, this practice is not without its disadvantages both for the countries and the agencies involved. Whenever international agencies provide assistance in areas such as legislative drafting or institution-building, they usually present their advice in the form of a self-contained package of solutions which is not meant to be unravelled into discrete segments. Against this background, the danger is that a Government receiving advice from more than one agency may be tempted to select elements of different proposed solutions without proper regard to the overall package presented by each agency. In addition, since the Governments concerned have had little experience in foreign investment matters, an eclectic approach could send confusing signals to foreign investors and, worst of all, could result in the incorporation of conflicting principles into particular régimes for foreign investment.

25. Finally, in some instances, the Centre encounters operational difficulties as a result of the piecemeal nature of the reform process in particular countries. Thus, for instance, the Centre was requested by one country to formulate regulations on joint ventures and then, in successive stages, to draft technology transfer and then labour regulations. Clearly, it would have been more desirable if there had been a single request pertaining to all three areas; then, the Centre would have been able to formulate a comprehensive and internally consistent package as a single effort. It should also be noted that when requests come in segments, this often requires an increased number of missions to the country concerned at a time when there are distinct limits on the Centre's financial resources.

III. FRAMEWORK FOR THE FORMULATION OF FOREIGN DIRECT INVESTMENT POLICIES

26. Transnational corporations can make an important contribution to local economic development when foreign investment policy is consistent with overall economic policy goals and objectives. It is therefore imperative that national economic development goals be clearly identified and be seen to be consistent with one another. Indeed, opportunities to obtain foreign direct investment inflows will be affected not only by the host countries' policies towards foreign direct investment, but also by the climate that exists in other parts of the economy.

27. In addition to the countries referred to in section II, numerous developing countries have revised their investment codes or promulgated new codes as a major ingredient of their strategy to attract foreign investment. This reliance on investment codes follows several precedents established in other developing countries in the post-Second World War era, and is perceived as an appropriate signal to transmit to investors, their home countries and international organizations as to the existence of a hospitable investment climate in each of the developing countries concerned. Yet, experience demonstrates that even the most liberal investment code, by itself, would be ineffective in improving the climate for savings and investment if it is inconsistent with the macro-economic policies of the host country. In other words, the code cannot be insulated as a coherent and self-sufficient instrument that addresses the major concerns of the foreign investor; in this regard, the host country's broad fiscal, monetary and exchange rate policies are more critical than the concessions stipulated in the code itself.

28. Thus, for example, the World Bank has urged developing countries that are undertaking structural adjustment programmes to ensure that the liberalization of their investment régimes is compatible with a package of broad economic reforms, including: liberalization of foreign exchange régimes through auctions or free convertibility, liberalization of financial markets, price liberalization, reforms in public sector management and public expenditure programmes, tax reforms and trade policy and wage policy reforms. Whether such a far-reaching programme of economic liberalization will ultimately be to the advantage of a host country is a matter for each sovereign State to decide, taking into account what it perceives to be its long-term political and social interests. What is emphasized here is that the purported liberalization of an investment code is ineffectual if it is at variance with the broad economic policies of the host country.

29. Similarly, investor concerns about political risk in the host country will not be assuaged merely by guarantees in the code in respect of expropriation, international arbitration, national treatment and full repatriation of dividends and other payments; instead, investors wish to be assured that the entire legal and judicial system provides fair and equitable treatment for foreign investment. The investment code is therefore, at best, only a part of the measures that have an impact on the overall investment climate.

30. Within this general context, it should also be noted that investment codes and similar instruments are most effective when they operate in a clear and unequivocal manner. Thus, the intentions of the Government should be transparent to foreign

investors and, at the same time, lower level officials should not have latitude to interpret and implement laws in unintended ways. In a South-East Asian country, the Centre found that there was a need to eliminate a complex and, in some cases, cumbersome system of screening and negotiating the incentives package for each project. This system of case-by-case negotiation of incentives and subsidies arose partly in order to offset prohibitively high tariffs on capital equipment or negative rates of effective protection. This inverted tariff structure, in turn, was a product of short-sighted revenue-seeking goals. With appropriate adjustments in this tariff system, therefore, the Government could move towards a more automatic approval system for small projects and direct its resources towards serious cost-benefit analysis of big projects which will have substantial impact on the economy. Yet, some cases may call for flexibility and discretion in applying the specified rules. For example, authorities may make special allowances when particularly desirable projects are under consideration. Policy makers must evaluate carefully this trade-off between clarity and flexibility. The general tendency is to formulate a general policy and complement it with specific criteria that justify special treatment.

IV. GENERAL FACTORS IN FOREIGN DIRECT INVESTMENT POLICY FORMULATION

A. Foreign direct investment in export-oriented activities

31. Transnational corporations are active in developing countries producing traditional commodities for export, such as petroleum, hard-rock minerals and cash crops, and facilitating non-traditional exports in the area of durable and non-durable consumer goods and capital goods. The formulation of policies in the area of traditional exports requires a considerable amount of expertise, given the tendency to volatility in market conditions. For example, as cited in the 1986 and 1987 reports of the Secretary-General on the experience gained in technical co-operation activities (E/C.10/1986/11 and E/C.10/1987/9), the experience of developing countries in devising an appropriate fiscal régime in mining is that, in trying to maximize its take from the mix of profits tax, additional profits tax, royalties and equity earnings, the typical government joint venture partner needs to build into the contract arrangements sufficient flexibility to allow for adjustment as international fortunes in the industry vary.

32. Accelerating the growth of non-traditional or manufacturing exports has become a priority for the Governments of many, if not most, developing countries or areas in the 1980s. This is attributed to four factors: (a) the development experience of countries or areas that followed an export-oriented growth policy has been generally favourable (e.g., the Republic of Korea, Taiwan Province of China, Singapore, Brazil and Hong Kong); (b) the debt crisis of developing countries has led to pressures to increase exports to finance imports and to service the external debt; (c) developing countries facing stagnant domestic demand can achieve some growth through exports; and (d) multilateral financial institutions have suggested, and in some cases mandated, export expansion as part of their restructuring programmes.

33. There is some question whether the success of export-oriented countries will yield similar benefits for other countries in the future. If developing countries expand their exports significantly faster, they may trigger higher import barriers. This was the case in the garment industry, where newcomers to export markets soon found themselves under quota restraints in the United States. As more developing countries launch export drives, the access situation could become more complicated. On the other hand, a large part of the export income earned by developing countries is often used to purchase goods and services from the developed countries, thus attenuating any adverse effects the latter may suffer from export drives of the developing countries.

34. Despite current and future difficulties in export markets, the need for developing countries to expand and diversify exports remains. Expansion of exports will promote growth and employment: diversification of exports away from commodities - whose prices fluctuate widely - is necessary to increase not only export volume, but also value per unit of investment. Diversification of exports is also desirable because, by stabilizing export revenue inflows, the Government may plan a more effective use of these resources.

35. Transnational corporations can facilitate the process of export growth and diversification. They can bring the necessary technology to produce higher-value-added products of export quality, and they possess the marketing knowledge and the network distribution systems to place and deliver the products abroad. In the early 1980s, a high percentage (20-40 per cent) of all the imports of high-income countries were through the intra-firm transfers of transnational corporations. In the mid-1980s, 40 per cent of United States imports, 30.3 per cent of Japanese imports and 30 per cent of United Kingdom imports were through intra-firm trade by transnational corporations. When the arm's-length exports of transnational corporation affiliates are added, their trade impact increases significantly.

36. Transnational corporations invest in export-oriented activities in host developing countries according not only to each country's location-specific advantages (e.g., availability of raw materials, relatively cheap labour and cost-efficient transportation networks to markets abroad), but also to the availability of foreign exchange and the going rate of exchange. A favourable rate of foreign exchange determines the cost of needed imported inputs and the value of each corporation's remittances of profits, dividends, royalties etc. The pursuit of a competitive exchange rate policy is essential, since such a policy is the corner-stone of an export-based development strategy and one important way to enhance the international competitiveness of the economy. A competitive exchange rate policy is also desirable from the corporations' point of view because their strategies are increasingly designed from a global perspective. Furthermore, given that exchange rate policies are intricately connected to other macro-economic policies, particularly fiscal and monetary policies, care must be taken that these policies do not result in abrupt exchange rate fluctuations.

B. Foreign direct investment to supply domestic markets

37. In choosing a location for an investment to satisfy the demand of the local population, a transnational corporation prefers a large market. Such a market not only earns the transnational corporation a large revenue, but also a high per unit rate of profit since economies of scale can be enjoyed. If the market is buoyant and growing at a fairly rapid rate, this constitutes an added attraction to the foreign investor.

38. Unless linkage industries already exist, transnational corporations would need access to imported inputs at competitive prices. A favourable import tariff system is essential. Many developing countries, for example, have a progressive tariff structure with the lowest tariff barriers for goods required at the initial production stages (e.g., capital equipment and raw materials), and the highest tariffs for finished goods which may be produced locally. In fact, such an import tariff scheme was at the core of import substitution policies which were in the mainstream during the 1960s. While such an approach may still work in many instances, in this age of increasing globalization, foreign investment by transnational corporations in projects to supply domestic markets is losing its importance vis-à-vis export-oriented investment. Additional attractive features (such as trade barriers to protect the markets of transnational corporations and their access to credit) will be discussed below in subsequent sections.

39. Experience has shown that many developing countries were too slow in devising policies to encourage transnational corporations to move beyond the first stage of the import substitution process in which non-durable consumer goods of a largely undifferentiated nature were produced, based on assembling foreign inputs and utilizing few backward and forward linkages. Eventually, the relevant authorities in large Latin American and certain East Asian States initiated policies to encourage import substitution of the second stage, involving the establishment of a local process industry (including chemicals, petrochemicals and metals) and the local production of differentiated goods, notably consumer durables and certain types of capital goods.

V. SYSTEMS OF INVESTMENT INCENTIVES

40. In their pursuit of foreign direct investment, many countries offer a wide variety of special incentives. These include factor-based incentives (e.g., tax holidays, loan guarantees, accelerated depreciation, tax rebates, wage subsidies and training grants) and commodity-based incentives (e.g., tariff and non-tariff import barriers). Evidence indicates that factor-based incentives are more effective in spurring exports, while commodity-based incentives are more effective in promoting production for the domestic market.

A. Export promotion incentives

41. Led by their needs to spur exports, an increasing number of developing countries are offering special incentives to attract export-oriented transnational corporation investment. In fact, in an attempt to compete more effectively for

export-oriented foreign direct investment, policy makers sometimes try to formulate incentives that are more beneficial to foreign investment relative to those offered in other developing countries, without taking sufficient care to ensure that their incentives will have a net positive impact on their country's development. Yet, the objective for development is not exports for exports' sake but rather efficiently produced value added for export promotion.

42. Many investment incentives offered by developing countries include tariff concessions. Specifically, these exempt material and equipment inputs to production from import duties, typically for 5 to 10 years, but sometimes for longer periods (e.g., Togo and Guinea). However, such concessions may be detrimental to host countries not only because of the resulting loss of revenue, but also because they may lead to inefficient production through distortions in the allocation of resources. For example, the exemption of custom duties on capital goods often encourages capital-intensive production at the expense of labour which is usually encumbered by tax and wage restraints. Capital-intensive production entails reliance on highly sophisticated technology which, in turn, involves continued dependence on expensive expatriate technical staff. Even more significantly, such fiscal incentives have the effect of sheltering inefficient companies from competition and thereby provide little inducement for domestic production of the exempted goods. Consequently, although the system of tariff concessions fosters import substitution in final goods, it may actually increase the country's reliance on imports.

43. At the same time, however, where exemption from import duties is designed for the advantage of exporters, this can be vital in promoting the country's exports on the world market. In this regard, it should be noted that the most successful exporters among the developing countries or areas, including the Republic of Korea, Singapore, Taiwan Province of China and Hong Kong, provide a tax-free régime for imported inputs, which are incorporated into products destined for export.

44. As a general rule, investment incentives should be simple and clear, leaving as little room as possible for the exercise of discretion. This will not only help to ensure that bureaucratic delays are kept to a minimum, but it will also reduce the possible number of occasions on which corrupt practices may be initiated.

45. Still on a general note, incentives to promote particular economic or social objectives must be narrowly focused and direct. Such specialized incentives can be geared to overcoming existing distortions or market failures to ensure that economically viable projects have sufficiently high financial rates of return to attract investors. In addition, they should be targeted as specifically as possible to achieve clearly defined goals. Thus, for instance, incentives to promote employment should not take the form of either exemptions for intermediate goods from import duty or accelerated depreciation, each of which has the effect of encouraging capital-intensive production; instead, they should be in the form of a training subsidy or tax credits for employment to correct for wages above the market level. Consistent with this approach, one African country has revised its investment code to eliminate certain misconceived incentives and to establish a value-added subsidy based on the wage bill for local labour.

46. There is some evidence that transnational corporations respond to promotional schemes in their investment decisions in export-oriented industries. For example, host countries frequently offer generous tax incentives since export-oriented investors that have real locational choices do shop around on the basis of fiscal relief. However, to be effective, these need to be coupled with appropriate double taxation treaties. The costs of these schemes to the countries providing them must be carefully weighed against the benefits of the resulting exports. It appears that, forced by their need to expand exports, developing countries as a group are competing against each other over which country can give the most attractive promotional privileges to export-oriented transnational corporations. The end-result of these promotional schemes may well be to shift such investment among developing countries and to shift the benefits arising from this export expansion from host countries to the transnational corporations that undertake the projects.

47. A relatively popular initiative for export promotion is through export processing zones, which now number over 200 in the developing world. Here, specific geographic areas within a country are exempt from most, if not all, national regulations and legislation as long as the goods produced are exported. Exemptions are granted on import tariffs and quotas; there are no restrictions on foreign exchange holdings, no financial reporting requirements, and national labour legislation is usually not binding in particular zones. Developing countries offering export processing zones include countries in all the developing regions, but they are more widespread in the Caribbean basin and in South-East Asia. Investment in export processing zones is concentrated in the production of labour-intensive, low-technology goods, such as textiles and leather products.

48. In various projects relating to export processing zones, the Centre found that obstacles to attracting larger magnitudes of foreign direct investment included the choice of a poor location and deficient institutional linkages between the export processing zone authority and the various government departments whose support and co-operation are necessary for the development of a zone. Another serious drawback is the lack of adequate infrastructural services, such as telecommunications and electricity supply. However, many national Governments do not have the resources to improve infrastructural facilities. In the Dominican Republic, the Government decided to shift ownership and/or management of export processing zones to the private sector, where resources abound. This approach has been successful and is in fact being applied in many other countries.

49. A valuable potential contribution of export processing zones to development goes beyond boosting exports. In fact, export processing zones provide an economically efficient point of departure for local development. Indeed, they offer an avenue to integrate gradually the local economy as a whole to world markets. For example, the requirement that all production must be exported may be gradually changed to allow a growing share of production to be sold in local markets, leading in this way to a gradual integration of the export processing zone to the overall local market. Experience has shown that, for large countries, access to the domestic market can be a powerful incentive.

50. Two other developments are worth noting. One is that the export processing zone authorities, instead of concentrating privileges and advantages on enterprises in a fixed territorial area, have sometimes found it appropriate to grant such benefits to other enterprises, local or foreign-owned, operating elsewhere in the country. A second development is the installation of domestic enterprises and joint ventures in formerly tradition-bound export processing zone locations. Today, only one third of the enterprises located in export processing zones are wholly foreign-owned.

51. In many export processing zones the contribution to development has been limited. It is clear that export processing zones increase employment and provide some foreign exchange gains. However, the effects on the skill level of the labour force may be negligible given that the industries that tend to locate in export processing zones have a low technology component. Furthermore, there is little evidence of either effective technology transfer within export processing zones or of strong economic linkages between enterprises based in export processing zones and other enterprises in the national economies of the countries concerned. More importantly, the machinery and equipment required for this type of production are quite flexible and may be easily moved from one production location to another: such industries may therefore be somewhat temporary in nature. Export processing zones have also been criticized for employing a high proportion of women workers who are both underpaid and overworked. However, unionization rates among the workers are fairly high and their wages tend to be higher than in local industries outside the export processing zones.

B. Incentives to promote import substitution activities

52. The most effective incentive to attract domestic-oriented foreign investment is protection for producers from competition. This approach was widely used in the past, under import substitution policies. Strict tariffs and quotas on imports were implemented to protect local industries from foreign competition until they developed, with the presumption that once they were strong enough protection would be lowered. Often, however, this infant industry approach led to the development of inefficient industries, which could not survive without continued protection, and merely allowed protected investors to earn excessively high profits. This negative effect was particularly severe when the host country blocked investment by other transnational corporations and domestic firms as an additional investment incentive.

53. To design an effective policy incentive system to attract foreign direct investment to produce goods for the local market, rationalization of protection should be undertaken, identifying selected industries and production processes for protection and determining periods of time during which the protection will be available. At the starting point, economic activities in which the country enjoys a comparative advantage must be identified. A tariff and quota policy may then be designed, selectively and according to which areas have been designated as priority for development. Within a particular economic activity, the lowest tariff rates are granted to goods needed to initiate production (capital equipment and some intermediate goods); the highest tariff rates should be allocated to those inputs

that are available locally. This protection should be offered only for the amount of time deemed necessary to develop that part of the production and should be closely enforced. As the local industry develops, the protection should be dismantled gradually so that the specific activity is integrated into world markets. Eventually, the protection is dismantled and the country may even become an exporter of such products.

54. Within this policy framework, transnational corporations have an important role to play. With protection from competition guaranteed for enough time to develop that industry, transnational corporations are more likely to invest. As such, they may provide the needed capital and technical expertise. If the country wants to ensure that the local sector benefits, it may opt for promoting joint ventures between local companies and transnational corporations and/or seeking access to licensed technology.

C. Other policies to attract foreign direct investment

55. Among the other policies adopted by developing countries, debt-equity conversions require special attention. Under this framework, an investor buys foreign debt paper in the secondary markets, where it is traded at large discounts; the investor is then allowed to convert the debt paper in the debtor country for an amount of local currency considerably greater than the normal exchange rates would permit and uses the proceeds to finance the investment project. In doing so, developing countries have found it necessary to take into account the need to avoid any inflationary effects of huge infusions of local currency (dollars converted at favourable rates) into the money supply.

56. While political, monetary, economic and other constraints clearly limit the scope of debt-to-equity conversions, a rapidly growing number of indebted countries are adopting various forms of this innovation. Among those countries whose programmes could be considered as interesting case-studies are the following: Chile, because it is regarded as the most successful of all the programmes currently in place; the Philippines, both because it is one of the few non-Latin American debtors to have made a major commitment to debt-equity conversion and because of the importance attached to the debt fund concept; Brazil, because (despite its suspension) its programme is potentially the most important and because of the surprising success of "informal" conversion; Mexico, because it resulted in a notable turnabout in foreign investment inflows in 1987, which the Government was able to channel into priority sectors; Argentina, because prior to its de facto suspension, the programme appeared to be succeeding in spite of a rather unpromising political environment; and Jamaica, since it is the only small country that has really tried to come to grips with the complex problems of instituting a formal debt-equity programme and because its programme is oriented most clearly towards export promotion.

57. However, debt-to-equity conversions are only a partial solution to the problem of debtor countries and should be viewed as useful but limited in the scope and volume of debt reduction and related new investment that may be generated. It is estimated that not more than 10 to 15 per cent of the foreign debt could be

converted into equity, the one exception to this generalization being Chile. The list of indebted countries implementing such schemes can be expected to grow as pressure mounts for the adoption of innovative techniques of external-debt management and foreign-investment management.

58. Given increasing competition for investment projects among developing countries, countries wishing to promote transnational corporation participation in the local economy may undertake, as part of their foreign direct investment policy, a systematic international publicity campaign to inform prospective investors about the country's economic advantages. This may involve conferences and forums, at home or abroad, organized by private and public sector business representatives. Also, use could be made of international business publications to include a few pages describing the country's location-specific advantages and treatment accorded to foreign direct investment. United Nations bodies, such as the Centre, have also assisted in identifying prospective foreign joint venture partners and in providing information on their financial strengths and developing country experiences. Central to the success of these policies is the need to adopt an activist approach.

59. Finally, certain organizations also exist specifically to facilitate the marketing of products abroad and for this purpose they assist in upgrading the technology from time to time so as to ensure consistent supply and quality. Among transnational corporations, the most successful in facilitating these arrangements are the sogo sosha, Japan's nine largest trading companies. They offer a wide variety of services that are scarce in developing countries, such as international marketing and distribution networks and foreign trade financing, and sometimes they even enter into joint venture partnerships with local producers.

VI. REGULATORY POLICIES

60. In their pursuit of foreign direct investment that will contribute to national development goals, policy makers use regulatory measures to control the entry of transnational corporations (so that only beneficial projects are undertaken) and enhance their performance (so as to maximize the net benefits to the country arising from the operations of the transnational corporations that are allowed to undertake projects). There are other regulatory measures that attempt to ensure that scarce resources (e.g., foreign exchange, finance) are channelled to activities that are most important for development. The following paragraphs examine the characteristics of these regulations.

A. Entry and ownership regulations

61. In an attempt to ensure that foreign investment activities comply with national policy goals, developing country authorities have at times limited foreign equity ownership in local ventures. Government regulations towards entry and ownership by transnational corporations have taken such forms as reserving certain industries solely for state ownership, reserving certain sectors for firms either wholly or partially owned by nationals, barring or restricting foreign acquisition of shares in domestically owned firms, requiring "fade out" or "fade down" of

foreign ownership over specified time periods, and requiring official approval for reinvestment of profits in some sectors of the economy or in other enterprises.

62. Over the past decade, there have been extensive changes in the policies of many developing countries in all these areas. The trend is toward relaxing regulations on transnational corporation investment and operations for several reasons. For example, rules barring majority foreign ownership do not guarantee control over transnational corporation operations. In fact, transnational corporations may control an operation without holding majority ownership because of their managerial expertise, access to foreign markets and technology and the like. Also, "fade out" or "fade down" provisions have not proved to be effective. They have raised fears among transnational corporations concerning eventual take-over by domestic firms, resulting in unfavourable reinvestment effects. In addition, experience in certain countries, such as Indonesia, has shown that there may not be a sufficient number of local entrepreneurs with the required capital and expertise to assume majority control over such enterprises. The trend over the past decade towards deregulation and privatization reflects the conclusion in many developing countries that these restrictive policies have not had the desired effects.

63. However, regulation of transnational corporation operations to ensure that they are consistent with national development goals is still necessary. To ensure that foreign direct investment contributes to national development goals, Governments are increasingly shifting from entry and ownership regulations to performance requirements, which will be discussed further below.

64. Transnational corporations have become more willing to form joint ventures with domestic partners for reasons already stated. Developing country Governments, for their part, tend to allow 100 per cent ownership of high-technology industries and those industries in which the bulk of the product is targeted for export.

B. Regulation of repatriation of profits and other external payments by transnational corporations

65. In an attempt to control foreign exchange outflows, many developing countries have implemented strict regulations for remittances by transnational corporations (e.g., dividends and profits, royalties, commissions and capital). In most instances, however, these controls have not proved very effective since they can be easily circumvented. As a result, many countries have recently relaxed their controls in this area. None the less, it is still true that developing countries demonstrate a wide variety of attitudes with respect to remittances of capital and profits. At one end of the spectrum, a certain East African country continues to insist that companies must maintain minimum reserves of 25 per cent of the paid-up capital and that dividends must not exceed 20 per cent of each company's net assets. At the other end, a southern African State has adopted a liberal régime which, in effect, allows free transfer of dividends, subject only to a 15 per cent tax on dividends remitted by non-resident shareholders.

66. Of course, from the investor's point of view, a liberal repatriation policy is more attractive than are those that impose important restrictions; but, at the same time, developing countries remain concerned about the possible negative effects of the liberal approach on their balance of payments. In light of these considerations, a possible long-term strategy is for countries to provide attractive economic incentives and a favourable business climate as a way of encouraging investors to reinvest their profits in the host country enterprise; this strategy is more desirable than one that involves the use of restrictive regulations, which may actually encourage companies to adopt impermissible techniques for the repatriation of capital and profits.

67. Even in the context of a more liberal approach, however, developing countries need regulations to monitor the outflow of remittances and to restrict transfer-pricing manipulation. To date, the Centre has responded to requests for assistance in this area from nearly a dozen countries, and although each case is unique, certain lessons may be drawn from the Centre's experience. For instance, it is clear that where a country wishes to reduce abusive transfer-pricing practices, steps should be taken to ensure that relevant government departments act in unison. In one South-East Asian country, early attempts at curbing such practices were stymied partly because different government agencies pursued incompatible policies. While the Customs Department welcomed high import prices because of the inflated effect on tariff revenue collected, these high prices reduced the tax liabilities of the transnational corporations operating in the country and lowered income tax proceeds. To rectify such a situation, consultations need to be held in order to determine the overall priorities of the Government in this area.

68. Finally, it should be noted that even where regulations are in place and governmental priorities are established, the issue of abusive transfer pricing is likely to remain problematic. For one thing, most developing countries, despite their best efforts, are comparatively ill-equipped to maintain the level of vigilance required to detect and control transfer-pricing manipulations when they occur. For another, transfer-pricing practices tend to arise in a wide variety of situations, with the result that it is sometimes difficult to identify occasions when prices are being set at an artificial level. Thus, while the issue of transfer pricing typically arises because of the existence of intra-firm trade across national borders, there are instances of transfer pricing in transactions between companies that are not part of the same corporate group. For example, "tie-in" clauses in a licensing agreement for patents, trade marks or know-how may require the licensee to buy the raw materials from the licensor at rates different from the open market price. In this type of situation, the relevant authorities need to have broad experience before they can state with certainty that transfer-pricing abuses are being perpetrated.

C. Performance requirements

69. In many developing countries, regulations and promotional measures have increasingly been tied to certain performance requirements that link the activities of transnational corporations directly to development goals. Performance requirements are based on certain operational factors, such as the size, domestic

ownership, transfer of technology, export orientation, employment generation, training, domestic value added, use of domestic raw materials and semi-finished inputs and components.

70. Incentives are increasingly being determined on the basis of performance rather than on the initial characteristics of the investment. Performance requirements can be effective, but this requires considerable skill on the part of the Government. If market forces are such that complying with the performance requirements is in the corporation's best interests or if the Government can affect the market so that this is the case, then the corporation will comply. In certain countries, for example, in India, the achievement of the enterprise has sometimes been much higher than the stipulated performance requirement.

71. Performance requirements for stimulating exports are most useful when transnational corporations already have incentives to export, such as a realistic exchange rate, export financing at international interest rates and access to needed inputs at world prices. The same holds for performance requirements with respect to employment, training, domestic value added and domestic ownership. For example, as the Japanese yen rose steeply during the period 1985-1988, Japanese transnational corporations rushed to invest in neighbouring countries and willingly complied with their performance requirements. In previous years, Japanese transnational corporations had resisted complying with performance requirements and had demanded major concessions before they would be induced to do so.

72. In Malaysia, rules governing foreign ownership were relaxed in 1986. According to the Investment Promotion Act, foreign investors are now permitted to hold up to 100 per cent equity ownership of a local operation if they fulfil simple and clearly specified requirements which contribute directly to the country's overall economic policy goals: raise investment levels over the next two years, generate additional foreign exchange and employment and bolster value added. Specifically, full foreign ownership is allowed to firms that (a) export at least 80 per cent of total production; (b) invest in the country before the end of 1990 and export at least 50 per cent of production, employ a minimum of 350 Malaysian workers or produce goods that do not compete with products already locally available. In addition, 51 per cent foreign ownership is permitted for producers of high-technology goods.

73. A similar development is under way in the Andean subregion. Countries in the Andean Pact (Bolivia, Colombia, Ecuador, Peru and Venezuela) have already liberalized or are in the process of liberalizing strict ownership rules dating back to the early 1970s for transnational corporations that export a major part of production and/or manufacture goods with a high local input content.

D. Access to local credit

74. In an attempt to channel the limited funds available to locally owned companies, some developing countries have regulations that limit transnational corporations' access to local credit. In general, access to local credit is determined according to the size of the company's capital base. While this may not

be a major consideration in the transnational corporations' choice for foreign direct investment location, discriminatory treatment of transnational corporations vis-à-vis local companies in general signals a negative attitude towards transnational corporations. However, such controls may be justified because (a) local credit is in short supply in most developing countries, and if local banks had a free choice they would lend their limited funds to transnational corporations more so than to local companies because the credit risk of transnational corporations is generally lower and the size of loan tends to be higher, thus lowering the costs of transactions; and (b) transnational corporations have access to competitively priced funding through transnational banks, while in many cases local companies do not.

75. The effectiveness of controls on access to local credit must be evaluated within the framework of each country's policies and priorities. In a project in an Asian country, for example, the Centre concluded that such controls were not effective in channelling scarce credit to local companies. There, the regulation consisted of limiting access to long-term credit through a graduated ceiling (50-70 per cent) of the foreign equity investment. However, the foreign company could obtain short-term credit and tap into equity, which defeated the purpose of credit control.

VII. IMPLEMENTATION OF FOREIGN DIRECT INVESTMENT POLICIES

76. In addition to the necessity for adequate negotiating capabilities, the effectiveness of foreign investment policies depends in part on the systems that administer and monitor them. An effective administration will ensure consistency between the official policies and their implementation. The more complex is a policy with its incentives and regulations, the more complex is the system needed to implement and monitor it. Therefore, in countries where the capacity to implement a policy is somewhat limited, a more simple and clear policy has a higher probability of succeeding.

77. During the course of the Centre's execution of its technical assistance projects related to foreign direct investment policies, it became evident that one of the major obstacles to the success of foreign direct investment policy is the lack of effective administration and monitoring systems. The irony is that the lower the level of economic development of a country, the lower the development of its administrative structures. Yet, the lower the level of a country's economic development, the greater may be the need for government regulation of the economy to achieve its development goals.

A. Strengthening and streamlining the administrative machinery

78. Changes in official attitude and policy direction should be accompanied by changes in administration. Often, although official government policies towards transnational corporations have changed, their administrative structures and personnel have not. As a result, there is often a disparity between official policies and how they are administered, which fosters confusion among prospective investors. In the Centre's experience, foreign investors often face special

problems because the bureaucracy in several developing countries is characterized by complex and cumbersome administrative procedures and practices. For instance, in one African country, each step of the investment process requires prior approval, supported by extremely detailed documentary evidence. As the approvals need to be obtained in a special order, and as there are no effective time limits at each stage of the process, investors must wait for an unduly long time before proceeding with their activities. Not only that, at several steps in the process, relevant officials often have overlapping responsibilities and, consequently, there is much duplication of effort. These considerations, together with the fact that there is no official source of information to guide investors through what has become a veritable maze of procedures, have led to a situation in which investors are regularly frustrated and investment costs are unnecessarily inflated.

79. In another well-documented case, a particular African country offers a system of tax incentives and reductions in import duties to foreign investors. To qualify for the incentives, the investor must supply proof to the Government that the project would not be viable without the incentives and must demonstrate that the project will, in effect, pay for itself during its life span. Among other things, this requires a carefully conducted feasibility study with projected cash flows over the life of the project and assumptions about future economic conditions in the country concerned. In any event, the feasibility study must be submitted not only to medium-level civil servants, but also to an Investment Commission, composed of some 13 high-ranking officials, and subsequently to the Council of Ministers and the President. On its own, this is inevitably a time-consuming process, but the situation is exacerbated by the fact that each aspect of the project, when approved by the Commission, also needs to be considered by separate government agencies. The upshot is that the entire procedure for approval may take over three years, and, as a result, almost all potential investors abandon their projects before they reach the implementation stage.

80. Against this background, an overwhelming case can be made for the removal of excessive bureaucratic procedures in the granting of approval for foreign investment projects. Whatever shape the screening mechanism takes, it should be simple, clear and predictable, and it must be based on objective criteria with a certain degree of flexibility. The choice of a particular screening and negotiating mechanism should be made according to local characteristics and development goals and priorities.

81. There are several options for national screening and approving of foreign investments, each one with particular advantages and disadvantages. They vary according to the degree of integration of functions and procedures under one institution, with total integration known as the "one-stop window". These options include the following:

(a) An autonomous centralized body, such as Singapore's. This approach leads to speedy screening and negotiating processes and is therefore less costly to investors. It also provides in-depth considerations of the project's impact on the overall economy. However, there is danger of excluding relevant and substantive government ministries and it lacks specific industry expertise;

(b) A co-ordination or interministerial body, as present in Indonesia, Thailand and the Philippines. The main advantage of this model is that it is less costly to investors (because it centralizes functions and thus speeds the decision process) and reduces conflicts at the government level. Co-ordination bodies are also able to take larger policy issues into account when evaluating a potential foreign direct investment. They also offer greater promotion opportunities. However, co-ordination bodies lack industry-specific expertise and are not involved in the implementation of the project once it has been approved;

(c) An ad hoc inter-agency or committee, which includes industry-specific expertise, as in Sri Lanka. However, it offers only limited consideration on the impact of a specific project on the economy as a whole, and lacks the link to promotion opportunities;

(d) A decentralized approach in which individual government departments separately cover their portfolios (i.e., the Ministry of Finance evaluates financial and fiscal considerations, the Ministry of Industry evaluates industrial impact etc.). While this approach accords specialized expertise to each aspect of the project and is linked to the implementation of the project (i.e., the same departments approve, administer and monitor the project), it is slow and costly to investors. This approach prevails in many African countries.

82. In screening investment projects, the Government may want to forego control over relatively small projects. For example, for Pakistan, it was considered that economic development would benefit if foreign investment, which represented less than 26 per cent of equity ownership in a local company, were treated as domestic investment, and thus subjected to much simpler rules. The same treatment would be desirable for small projects (i.e., investment under a specified amount of money). Finally, the screening process should be simpler for activities in priority designated areas and more complex where reserved-market policies dominate.

83. A recurrent problem is the amount of red tape and confusion about which organization or official is responsible for what operations of transnational corporations (e.g., getting approvals for income remittances and imports and taking advantage of specific incentives). A solution to this problem is to apply the concept of a "one-stop window", as mentioned above. This rather centralized approach requires the creation of a single government entity responsible for all arrangements and paperwork related to foreign investments. The "one-stop window" may also alleviate delays in getting approvals and access to incentives, which is one of the major constraints to effective policy implementation in developing countries. The problem is that, frequently, in developing countries, middle-level administrators do not feel comfortable taking responsibility for making decisions. As a result, top administrators become overburdened with excessive paperwork and decisions that should be the responsibiliy of middle-level officials. The team approach of the "one-stop window" alleviates this problem, provided that its members are well trained. This approach should be complemented by specifying a time period within which a particular type of permit will be granted or government action taken (e.g., a foreign investment project will be approved within 30 working days after it is submitted to the proper authorities). In recent years, a number of countries have sought the assistance of the Centre in establishing such one-stop systems.

84. While the one-stop window has certain advantages in terms of ensuring speed, consistency in approach to foreign investors and effective evaluation of overall economic benefits and costs, including upstream and downstream consequences, experience has shown that the system is not without its drawbacks. Countries with long experience of this decentralized model, such as Singapore, have found that little industry expertise is brought to bear on the decision-making and that policy-making tends to be divorced from the various separate government agencies responsible for implementation. On the other hand, in one Caribbean country which is in the process of introducing a one-stop system, progress has been slow because of various ministries attempting to retain their authority over those aspects of foreign direct investment that currently fall within their purview. There also appears to be conflict in some ministries between policy-level officials who adhere to the overall new liberal approach to foreign investment and long-standing officials who are less enthusiastic about these developments. In one African country which recently approached the Centre for assistance in setting up a one-stop system, it was found that such an exercise would not be very effective unless the Government was also prepared to amend substantially the existing foreign investment regulatory framework to make it more consistent and less cumbersome and restrictive. In that country, there are 5 laws, 18 decrees and 1 edict concerning the activities of government organizations dealing with foreign investment, plus 20 laws, 17 decrees and 2 edicts relating to foreign investment, per se, along with other laws having a less direct bearing on the operations of transnational corporations.

B. Monitoring foreign direct investment performance and impact on the economy

85. A monitoring system on the impact of foreign direct investment on the local economy is crucial to evaluate the performance of foreign direct investment policies. It also alerts policy makers when changes in policies are required, and it may give some indication about the content of such changes. As stated in section I, foreign direct investment policy formulation requires the consideration of various factors relative to the national economy and the international environment. Since, these factors are ever-changing, subtle changes in foreign direct investment policy are continuously required and a monitoring system is necessary to determine the impact. In short, without data there can be no evaluation, without an evaluation of the performance of the policies, host Governments can have no systematic basis for changing the system to make it more effective.

86. Appropriate data on the outcomes and performance of approved projects are valuable for several reasons. At the macro-economic level, statistics on investment (foreign or otherwise) are a vital component of the gross national product statistics. Data on employment, output, capacity utilization, exports and so on are also significant inputs to economic analysis directed towards general economic policy decisions. Data on a realized level, sectoral distribution and other characteristics and effects of past foreign investment projects are necessary inputs to the formulation and implementation of policies towards future investment proposals and the appropriate role of economic incentives.

87. The following illustration may serve as an example of an inadequate monitoring system. In a certain Asian country, if a foreign firm wishes to receive incentives, it must submit its investment project to a board responsible for foreign investment approval and monitoring. If a firm is granted such incentives, it is required to file a yearly income statement and balance sheet and to provide a few other statistics such as number of employees, output, assets and so on. A Centre study of this country revealed that less than half of all firms receiving incentives had filed the data; the data filed are not checked; the declared penalty for non-compliance is low and yet sanctions have never been levied. The data published by the board are based on the latest available information, involving aggregating data from original investment proposals (for firms that have not filed an update) with current data (for firms that have). Yet these data are used for analysis of aggregate foreign direct investment in the country, the sectoral and country of origin distributions and other public policy purposes. These data are incomplete, inaccurate and most likely biased, but in unknown directions. Beyond these statistical problems, there is no systematic means by which the Government can know whether firms operate in accordance with the undertakings they made when they applied for investment incentives. The basis for taking appropriate corrective action is therefore limited.

88. At the other extreme is Singapore, with the simplest economic goals - growth and efficiency - and the fewest regulations on foreign direct investment; it allows its economy to be exposed to the rigours of international trade, and it uses a competitive market system to force firms to make those adjustments that are required for growth and efficiency. Yet, of all the countries in the region, Singapore collects the most detailed and most accurate data on foreign direct investment and the operations of transnational corporations. For countries having more complex goals and more complex regulatory and promotional systems for foreign direct investment, an absolute prerequisite is to collect, analyse and evaluate appropriate data on the operations of foreign firms, not just at the time their investment receives approval, but in subsequent years.

VIII. CONCLUSIONS

89. Current trends towards a more integrated global economy will continue into the 1990s. This integration is expected to increase within a framework of intensified competition, expansion of free-market mechanisms and faster technological change oriented towards reducing production costs while at the same time increasing product diversification and quality control. At the same time, the global integration process has a strong regional dynamic. Already, economic integration is occurring faster than anybody could have predicted, with economic powers expanding beyond national borders and towards regional groupings. Examples include the European Economic Community (1992), the "North American bloc" (including the United States, Canada and, increasingly, Mexico), the Association of South-East Asian Nations (ASEAN) and the East European bloc. Efforts towards regional integration have also been intensified in Latin America (the Central American Common Market, the Andean Pact, the Latin American Integration Association and the Caribbean Common Market (CARICOM) and in Africa (e.g., the Economic Community of West African States (ECOWAS), the South African Development Co-ordination

Conference (SADCC), the Preferential Trade Area for Eastern and Southern African States (PTA), the Central African Customs and Economic Union (UDEAC) and the Arab Maghreb Union (UMA)). The role of transnational corporations in this integration process will continue to be crucial. The recent developments in North America and Western and Eastern Europe suggest a continuation of the trend towards a growing share of North-North, rather than North-South, investment flows.

90. Many developing countries in Africa and Latin America are in the greatest need but are the least capable of making the required adjustments in a rapidly changing and technologically dynamic world. Although the expected role of transnational corporations in filling these countries' resource gaps is limited, much more could be done to enhance their contribution to these countries' development, particularly with respect to the new open-door economies. This will require a more efficient and effective formulation and implementation of foreign investment policies by the Governments of these countries.

91. In this regard, the role of the Centre in providing technical assistance may be significant. Through its advisory and information services, the Centre can further help host countries in designing policies, laws and regulations that will attract foreign direct investment under appropriate terms and conditions. The Centre also provides advisory and information services with respect to assisting developing countries to forge mutually beneficial technological and other non-equity related arrangements with transnational corporations. Finally, the Centre's training programme makes it possible to engage in intensive dialogue with government officials who are actually involved in the formulation and implementation of these foreign investment policies, and regional workshops facilitate an exchange of views among officials from neighbouring countries with similar economic and social objectives.